

# Highlands and Islands Enterprise

Annual Audit Plan 2021/22



 AUDIT SCOTLAND

Prepared for Highlands and Islands Enterprise

March 2022

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# Introduction

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## Summary of planned audit work

1. This document summarises the work plan for our 2021/22 external audit of Highlands and Islands Enterprise (HIE). The main elements of our work include:

- evaluation of the key controls within the main accounting systems
- an audit of the financial statements and provision of an Independent Auditor's Report
- an audit opinion on regularity and other statutory information published within the annual report and accounts including the Performance Report, the Governance Statement and the Remuneration and Staff Report
- consideration of arrangements in relation to the audit dimensions that frame the wider scope of public sector audit: financial management, financial sustainability, governance and transparency and value for money
- consideration of Best Value arrangements
- providing assurance on the Whole of Government Accounts (WGA) return
- reviewing HIE's participation in the National Fraud Initiative.

## Impact of Covid-19

2. The coronavirus disease (Covid-19) pandemic has had a significant impact on public services and public finances, and the effects will be felt well into the future.

3. Audit Scotland continues to assess the risks to public services and finances from Covid-19 across the full range of our audit work, including annual audits and the programme of performance audits. The well-being of audit teams and the delivery of high-quality audits remain paramount. Changes in our approach may be necessary and where this impacts on annual audits, revisions to this Annual Audit Plan may be required.

## Adding value

4. We aim to add value to HIE through our external audit by being constructive and forward looking, by identifying areas for improvement and by recommending and encouraging good practice. In so doing, we will help HIE improve standards of governance, better management and decision making and more effective use of resources. Additionally, we attend meetings of the Risk and Assurance Committee (RAC) and actively participate in discussions.

## Respective responsibilities of the auditor and HIE

5. The [Code of Audit Practice \(2016\)](#) sets out in detail the respective responsibilities of the auditor and the organisations we audit. Key responsibilities are summarised below.

### Auditor responsibilities

6. Our responsibilities as independent auditors are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice](#) (including [supplementary guidance](#)) and guided by the Financial Reporting Council's Ethical Standard.

7. Auditors in the public sector give an independent opinion on the financial statements and other information within the annual report and accounts. We also review and report on the arrangements within the audited body to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

### HIE's responsibilities

8. HIE is responsible for maintaining accounting records and preparing financial statements that give a true and fair view.

9. HIE also has the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable HIE to deliver its objectives.

## Managing the transition to 2022/23 audits

10. Audit appointments are usually for five years but were extended to six years due to Covid-19. 2021/22 is the final year of the current appointment and we will work closely with our successors to ensure a well-managed transition.

# Financial statements audit planning

## Materiality

**11.** Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. We are required to plan our audit to determine with reasonable confidence whether the financial statements are free from material misstatement. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the matter arising.

### Materiality levels for the 2021/22 audit

**12.** We assess materiality at different levels as described in [Exhibit 1](#). The materiality values for HIE and its group are set out in [Exhibit 1](#).

## Exhibit 1

### 2021/22 Materiality levels for HIE

Materiality	HIE	Group
<b>Planning materiality</b> – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It has been set at 1 per cent of gross expenditure for the year ended 31 March 2022 based on the latest audited financial statements for 2020/21.	£940,000	£940,000
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement, we have assessed performance materiality at 40 per cent of planning materiality.	£376,000	£376,000
<b>Reporting threshold (i.e. clearly trivial)</b> – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.	£50,000	£50,000

Source: Audit Scotland

## Significant risks of material misstatement to the financial statements

**13.** Our risk assessment draws on our cumulative knowledge of HIE, its major transaction streams, key systems of internal control and risk management processes. Also, it is informed by our discussions with management, meetings with internal audit, attendance at committees and a review of supporting information.

**14.** Based on our risk assessment process, we identified the following significant risks of material misstatement to the financial statements. These are risks which have the greatest impact on our planned audit procedures. [Exhibit 2](#) summarises the nature of the risk, the sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurance over the risk.

### Exhibit 2

#### 2021/22 Significant risks of material misstatement to the financial statements

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p><b>1. Risk of material misstatement due to fraud caused by the management override of controls</b></p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance</p>	<ul style="list-style-type: none"> <li>• Assess the design and implementation of controls over journal entry processing.</li> <li>• Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.</li> <li>• Test journals at the year-end and post-closing entries and focus on significant risk areas.</li> <li>• Consider the need to test journal entries and other adjustments during the period.</li> <li>• Evaluate significant transactions outside the normal course of business.</li> <li>• Assess the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements.</li> <li>• Assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.</li> </ul>

Significant risk of material misstatement	Sources of assurance	Planned audit response
		<ul style="list-style-type: none"> <li>• Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year.</li> <li>• Focussed testing of accounting accruals and prepayments.</li> </ul>
<p><b>2. Risk of material misstatement in accounting estimates and judgements in provisions</b></p> <p>There is a significant degree of subjectivity in determining provisions relating to the reinstatement of the Cairngorm funicular.</p> <p>There is potential for material change in costs as a result of market prices and the complexity of the location of this project.</p> <p>There is a risk of misstatement in the accuracy of amounts provided in the financial statements.</p>	<p>Detailed project monitoring for the funicular project is in place. This includes external project management and certification.</p> <p>HIE will provide a document to support key assumptions and judgements as part of its working paper package.</p>	<ul style="list-style-type: none"> <li>• Review whether disclosure reflects our understanding of the business.</li> <li>• Review the work done by management and rationale used to assess costs included in the provision.</li> <li>• Substantive testing of information used to assess provisions and related disclosures, including any contingent liabilities.</li> </ul>

Source: Audit Scotland

**15.** As set out in International Standard on Auditing (UK) 240: *The auditor's responsibilities relating to fraud in an audit of financial statement*, there is a presumed risk of fraud over the recognition of revenue. There is a risk that revenue may be misstated resulting in a material misstatement in the financial statements. We have rebutted this risk for HIE because income streams are generally grant in aid funding from the Scottish Government, partner funding from other public sector bodies and rental income from HIE's property portfolio. We have previously tested the systems for these funding streams and confirmed that the controls operate as expected.

**16.** In line with Practice Note 10: *Audit of financial statements and regularity of public sector bodies in the United Kingdom*, as most public-sector bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk relating to revenue recognition. We have rebutted this risk for HIE because most expenditure is directly supported by systems where we have previously confirmed that controls operate as expected. In addition, the type of payments involved are not complex and generally relate to contracts or grant agreements.

**17.** We have not, therefore, incorporated specific work into our audit plan in these areas over and above our standard audit procedures.

## Other areas of audit focus

**18.** As part of our assessment of audit risks, we have identified other areas where we consider there are also risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we do not consider these to represent significant risks. We will keep these areas under review as our audit progresses. If our assessment of risk changes and we consider these risks to be significant, we will communicate this to management and those charged with governance and revise our planned audit approach accordingly.

**19.** The areas of specific audit focus are:

- **Estimates and judgements: valuation of pension liabilities and land and buildings** - HIE relies on external management experts (actuaries and professional valuers) to provide information that is subsequently included in its annual report and accounts. As part of our audit, we will review the work of these management experts. We will also consider the controls HIE has in place over the expert's work and will follow up the recommendations made in our 2020/21 Annual Audit Report in this area.

## Group consideration

**20.** As group auditors, we are required under International Standard on Auditing (UK) 600: *Audits of group financial statements (including the work of component auditors)* to obtain sufficient appropriate audit evidence on which to base our audit opinion on the group financial statements.

**21.** HIE has a group which comprises component entities, including subsidiaries, and joint ventures. The audits of the financial information of some of the components are performed by other auditors. We plan to place reliance on the work of the component auditors. We will obtain sufficient appropriate audit evidence in relation to the consolidation process and the financial information of the components on which to base our group audit opinion.

## **Audit risk assessment process**

**22.** Audit risk assessment is an iterative and dynamic process. Our assessment of risks set out in this plan may change as more information and evidence becomes available during the progress of the audit. Where such changes occur, we will advise management and where relevant, report them to those charged with governance.

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# Audit dimensions and Best Value

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## Introduction

23. The [Code of Audit Practice](#) sets out the four dimensions that frame the wider scope of public sector audit. The Code of Audit Practice requires auditors to consider the adequacy of the arrangements in place for the audit dimensions in audited bodies.

## Audit dimensions

24. The four dimensions that frame our audit work are shown in [Exhibit 3](#).

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### Exhibit 3

#### Audit dimensions



Source: Code of Audit Practice

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25. In summary, the four dimensions cover the following:

- **Financial management** – financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Financial sustainability** – as auditors, we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on financial sustainability in the longer term. We define this as medium term (two to five years) and longer term (longer than five years).

- **Governance and transparency** – governance and transparency are concerned with the effectiveness of scrutiny and governance arrangements, leadership, and decision-making and transparent reporting of financial and performance information.
- **Value for money** – value for money refers to using resources effectively and continually improving services.

## Duty of Best Value

26. [Ministerial Guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) explain that accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. We will be carrying out a high-level review to confirm that such arrangements are in place within HIE.

27. We will also be carrying out a review of the Best Value characteristic “fairness and equality” within HIE.

## Audit dimension risks

28. We did not identify any new audit dimension risks this year and so our focus will be on following up prior year recommendations including:

- **financial sustainability** - HIE will continue to have a key role in the recovery and renewal of the Highlands and Islands economy post-Covid whilst continuing to face significant financial pressures in areas where there is uncertainty about the timing and amount of potential expenditure (e.g. reinstatement of the Cairngorm funicular railway, Spaceports development and Nigg East Quay project). We will review monitoring reports and the financial position at the year-end including performance against resource limits set by the Scottish Government
- **capacity of the finance team** - we have reported previously on the need for HIE to ensure it has sufficient skills and capacity within its finance team. Last year, there was some evidence that the addition of new posts had improved the finance team’s capacity, but we had yet to see significant improvement in accounting for complex areas such as capital accounting, financial transactions, and investments. We will continue to review progress made in developing the skills required by the finance team to ensure that these complex areas are appropriately reflected in the annual report and accounts.
- **cyber security** - HIE now has Cyber Essentials Plus accreditation. We will review HIE’s oversight of the continuing risks to cyber security in the public sector, including updates provided to the RAC and relevant internal audit reports.

# Reporting arrangements, timetable, and audit fee

## Reporting arrangements

**29.** Audit reporting is the visible output for the annual audit. All Annual Audit Plans and the outputs, as detailed in [Exhibit 4](#), and any other outputs on matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

**30.** Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft reports will be issued to the relevant officers to confirm factual accuracy.

**31.** We will provide an independent auditor's report to HIE, the Scottish Parliament and the Auditor General for Scotland setting out our opinions on the annual report and accounts. We will provide HIE and the Auditor General for Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

**32.** [Exhibit 4](#) outlines the target dates for our 2021/22 audit outputs which reflect available audit resources and prioritisation decisions (see paragraph 34 below) and aim to ensure that the statutory requirement to lay HIE's audited accounts in the Scottish Parliament by 31 December 2022 is achieved.

## Exhibit 4 2021/22 audit outputs

Audit Output	Target date	Risk and Assurance Committee date
Annual Audit Plan	8 March 2022	15 March 2022
Annual Audit Report and proposed Independent Auditor's Report	29 November 2022	6 December 2022
Independent Auditor's Report (signed)	6 December 2022	N/A

Source: Audit Scotland

## Timetable

**33.** The effect of Covid-19 on the 2019/20 and 2020/21 audits means that we are starting the 2021/22 audits later than in previous years. We expect that this year will continue to be challenging and we have reviewed resources and timings across the audits which Audit Scotland delivers.

**34.** In the interests of public accountability, and with a view to the new audit appointments from 2022/23, Audit Scotland is prioritising NHS, agency and council audits. Although the target date for the completion of NDPB audits (including HIE) is 31 October 2022, this cannot be met in all cases. The overriding statutory requirement is for the audited accounts to be laid in the Scottish Parliament by the statutory deadline of 31 December 2022, and our aim is to complete all audits in time to achieve that deadline. As noted in paragraph 3, however, the well-being of audit teams and the delivery of high-quality audits remain paramount.

**35.** We have included the proposed timetable for the audit of HIE at [Exhibit 5](#) which has been discussed with management and members of the Risk and Assurance Committee. We continue to seek ways to work more efficiently to expedite the 2021/22 audits whilst at the same time maintaining high standards of quality. Progress against the proposed timetable will be discussed with management and finance officers over the course of the audit.

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## Exhibit 5

### Proposed annual report and accounts timetable

 Key stage	 Date
Latest submission date for the receipt of the unaudited annual report and accounts with complete working papers package.	4 July 2022
Latest date for final clearance meeting with the Director of Finance and Corporate Services	21 November 2022
Agreement of audited and unsigned annual report and accounts	28 November 2022
Signed Independent Auditor's Report	6 December 2022

Source: Audit Scotland

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**36.** To support an efficient audit, it is critical that high quality unaudited accounts and supporting working papers are provided and that the timetable for producing the annual report and accounts for audit is achieved.

## Audit fee

**37.** The agreed audit fee for the 2021/22 audit of HIE is £144,110 (2020/21: £141,390). In determining the audit fee, we have taken account of HIE's risk exposure, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit.

**38.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited annual report and accounts, the absence of adequate supporting working papers or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises out with our planned audit activity.

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# Other matters

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## Internal audit

**39.** Internal audit is provided by HIE's in-house internal audit team supported by Azets who provide specialist and additional resources as required. In addition, HIE has developed a joint approach to IT audit with the internal auditors of Scottish Enterprise (SE), South of Scotland Enterprise (SoSE) and Skills Development Scotland (SDS) to obtain assurances over the operation of Enterprise Information Systems (EIS) which delivers ICT services to all bodies. This contract is also used for wider ICT and information governance assurance activity for both the Partnership and HIE specific activity.

**40.** International standards on Auditing (UK) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect on external audit procedures
- obtain an understanding of internal audit activities to inform our planning and develop an effective audit approach that avoids duplication of audit effort
- perform a preliminary assessment of the internal audit function when there is scope for relying on internal audit work which is relevant to our financial statements' responsibilities
- evaluate and test the work of internal audit, where use is made of that work for our financial statements responsibilities to confirm its adequacy for our purposes.

**41.** Our preliminary assessment of HIE's internal audit function concluded that internal audit's work can be used for external audit purposes. As in previous years, we plan to place formal reliance on internal audit's substantive testing of significant transactions.

**42.** In respect of our wider dimension audit responsibilities, we also plan to consider other areas of internal audit work including:

- review of loans
- certificates of assurance and disclosures in the governance statement.

**43.** We will also consider the internal audit arrangements for EIS which are jointly procured by HIE and its partners.

## Independence and objectivity

**44.** Auditors appointed by the Auditor General for Scotland must comply with the [Code of Audit Practice](#) and relevant supporting guidance. When auditing the financial statements, auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has robust arrangements in place to ensure compliance with these standards including an annual *'fit and proper'* declaration for all members of staff. The arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

**45.** The engagement lead (i.e. appointed auditor) for HIE is currently Gordon Smail, Audit Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of HIE.

## Quality control

**46.** International Standard on Quality Control (UK) 1 (ISQC1) requires a system of quality control to be established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

**47.** The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the [Code of Audit Practice](#) (and supporting guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews. Additionally, the Institute of Chartered Accountants of Scotland (ICAS) have been commissioned to carry out external quality reviews.

**48.** As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time, and this may be directed to the engagement lead.

# Highlands and Islands Enterprise

## Annual Audit Plan 2021/22

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:

[www.audit-scotland.gov.uk/accessibility](http://www.audit-scotland.gov.uk/accessibility)

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