

# Highlands and Islands Enterprise

2020/21 Annual Audit Report



 AUDIT SCOTLAND

Prepared for Highlands and Islands Enterprise and the Auditor General for Scotland

September 2021

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# Key messages

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## Audit of 2020/21 annual report and accounts

- 1 The financial statements of Highlands and Islands Enterprise and its group give a true and fair view of their financial position at 31 March 2021 and their net expenditure for the year.
- 2 The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.
- 3 The other information in the annual report and accounts is consistent with the financial statements and is in accordance with the legal requirements.

## Financial management and sustainability

- 4 Financial management in 2020/21 was effective. HIE remained within its overall grant in aid budget for the year, and successfully adapted its internal controls to meet the challenges of operating under Covid-19.
- 5 HIE administered thirteen Covid-19 support schemes during 2020/21, involving over 1,700 applications and more than £43 million of awards to businesses and community groups to help them manage the financial impacts of the pandemic.
- 6 HIE continues to face significant financial challenges and uncertainties, not least related to the funding of activities on Cairngorm Mountain and the reinstatement of the funicular railway.

## Governance, transparency, and value for money

- 7 Appropriate governance arrangements were in place in 2020/21, with scope for improvement in the oversight of financial write-offs.
- 8 The Performance Report was revised to provide a more balanced picture of performance. We are satisfied that the report now meets the requirements of the Financial Reporting Manual.
- 9 HIE has an effective framework for assessing best value.
- 10 Performance targets were not set for 2020/21, but performance monitoring continued. This shows an increase in performance against the majority of HIE's primary outcome measures despite the pandemic.

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# Introduction

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**1.** This report summarises the findings from our 2020/21 audit of Highlands and Islands Enterprise (HIE).

**2.** The scope of our audit was set out in our Annual Audit Plan which was presented to the Risk and Assurance Committee in March 2021. This report sets out the findings from the main elements of our audit work:

- a review of HIE's key financial systems
- the audit of HIE's 2020/21 annual report and accounts including the issue of an independent auditor's report setting out our opinions
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#).

**3.** In common with all organisations, HIE had to respond to the coronavirus pandemic (Covid-19) during 2020/21. It led the delivery of several grant schemes and helped to deliver others to support businesses in the Highlands and Islands region through the pandemic. We included risks related to the pandemic in our annual audit plan and adapted our planned audit work to address emerging risks.

## Adding value through the audit

**4.** We add value to HIE through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

## Responsibilities and reporting

**5.** HIE has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with the accounts direction from the Scottish Ministers.

**6.** HIE is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

**7.** Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), and supplementary guidance and International Standards on Auditing in the UK. As public sector auditors we give independent opinions on the annual report and accounts. Additionally, we conclude on:

- the appropriateness and effectiveness of the performance management arrangements
- the suitability and effectiveness of corporate governance arrangements
- the financial position, and arrangements for securing financial sustainability.

Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**8.** This report raises matters from our audit. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

**9.** Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers, and dates for implementation. It also includes any outstanding actions from last year and progress against these.

## **Auditor independence**

**10.** Auditors appointed by the Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

**11.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and that the 2020/21 audit fee of £141,390, set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**12.** This report is addressed to both HIE and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

**13.** We would like to thank the management and staff who have been involved in our work for their cooperation and assistance during the audit.

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# 1. Audit of 2020/21 annual report and accounts

The principal means of accounting for the stewardship of resources and performance

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## Main judgements

The financial statements of HIE and its group give a true and fair view of their financial position at 31 March 2021 and their net expenditure for the year.

The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

The other information in the annual report and accounts is consistent with the financial statements and was prepared in accordance with legal requirements.

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## Our audit opinions on the annual report and accounts are unmodified

**14.** The annual report and accounts for the year ended 31 March 2021 were approved by the Risk and Assurance Committee on 23 September 2021. As reported in the independent auditor's report:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were regular and in accordance with applicable enactments and guidance
- the performance report, governance statement and the audited part of the remuneration and staff report were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

## The annual report and accounts were provided on time

**15.** HIE and Audit Scotland staff continued to work from home for the duration of the audit. We kept in regular communication with management throughout the audit. Despite the challenges of remote working, the audit was completed in line with the planned timetable.

16. We received the unaudited annual report and accounts on 14 June 2021 in keeping with the timetable. Management provided support to the audit team and we were able to complete the audit in accordance with the agreed timetable. The standard of some working papers could be improved. For example, the working paper for the cash flow statement contained a number of errors.

## Overall materiality is £915,000

17. Our initial assessment of materiality was carried out during the planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual report and accounts and is summarised in [Exhibit 1](#).

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### Exhibit 1 Materiality values

| Materiality level       | Single entity | Group    |
|-------------------------|---------------|----------|
| Overall materiality     | £915,000      | £915,000 |
| Performance materiality | £365,000      | £365,000 |
| Reporting threshold     | £50,000       | £50,000  |

Source: Audit Scotland

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## [Appendix 2](#) identifies the main risks of material misstatement and our audit work to address these

18. [Appendix 2](#) provides our assessment of the risks of material misstatement in the annual report and accounts and any wider audit dimension risks. These risks influenced our overall audit strategy, the allocation of staff resources to the audit and indicate how the efforts of the audit team were directed. [Appendix 2](#) also identifies the work we undertook to address these risks and our conclusions from this work.

## Significant findings from the audit of the annual report and accounts

19. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of HIE's accounting practices.

20. The significant findings are summarised in [Exhibit 2](#). Where a finding has resulted in a recommendation to management, a cross-reference to the action plan in [Appendix 1](#) is included.

## Exhibit 2

### Significant findings from the audit of financial statements

| Issue   | Resolution   |
|---|--|
| <p><b>1. Revaluation of assets held for sale</b></p> <p>Assets classified as ‘held for sale’ were revalued upwards at 31 March 2021. This accounting treatment is incorrect and does not comply with HIE’s accounting policy.</p> <p>Property, plant, and equipment was overstated by £0.132 million, with net expenditure understated by £0.102 million and the revaluation reserve overstated by £0.030 million in the unaudited accounts.</p>            | <p>Management agreed to amend the accounts to correct this misstatement.</p> <p>We are content with the accounting treatment in the 2020/21 accounts.</p> <p><b>Recommendation 1</b></p> |
| <p><b>2. Calculation of depreciation</b></p> <p>The depreciation charge for plant and equipment held at Cairngorm was incorrectly calculated, resulting in some assets having a carrying amount less than estimated residual value.</p> <p>Net expenditure was overstated, and non-current assets were understated by £0.056 million in the unaudited accounts.</p>   | <p>Management agreed to amend the accounts to correct this misstatement.</p> <p>We are content with the accounting treatment in the 2020/21 accounts.</p> <p><b>Recommendation 1</b></p> |
| <p><b>3. Accounting for capital receipts</b></p> <p>Grant income was offset against the capitalised cost of an asset it was part-funding. The Financial Reporting Manual (FRM) does not permit this accounting treatment.</p> <p>As a result, income and operating expenditure were understated by £0.652 million in the unaudited accounts. There was no impact on the carrying amount of non-current assets as HIE revalues all its assets each year.</p> | <p>Management agreed to amend the accounts to correct this misstatement.</p> <p>We are content with the accounting treatment in the 2020/21 accounts.</p> <p><b>Recommendation 1</b></p> |
| <p><b>4. Classification of assets under construction</b></p> <p>£1.3 million of development costs on the MyHIE IT project were classified as property, plant, and equipment in the unaudited accounts instead of an intangible asset under construction.</p>  | <p>Management agreed to amend the accounts to correct this misstatement.</p> <p>We are content with the accounting treatment in the 2020/21 accounts.</p> <p><b>Recommendation 1</b></p> |

| Issue  | Resolution   |
|--|--|
| <p><b>5. Accounting for Financial Transactions</b></p> <p>HIE used £0.060 million of Financial Transactions funding during the year. Unlike other grant in aid funding, Financial Transactions funding has to be repaid to the Scottish Government.</p> <p>HIE had not recognised this liability to repay the Scottish Government in 2020/21 or 2019/20, the first year HIE used Financial Transactions funding.</p> <p>As a result, liabilities were understated, and taxpayer's equity was overstated by £0.935 million in the unaudited accounts.</p> | <p>Management agreed to amend the accounts to correct this misstatement. A prior period adjustment has been included in the 2020/21 accounts.</p> <p>We are content with the accounting treatment in the 2020/21 accounts.</p> <p><b>Recommendation 3</b></p>  |
| <p><b>6. Accounting for HIE's investment in Orkney Research and Innovation Campus (ORIC)</b></p> <p>HIE invested a further £0.080 million in ORIC during 2020/21, bringing its total investment to £3.3 million since 2017/18. This investment was treated as expenditure in the HIE single entity accounts.</p> <p>As a result, financial assets and taxpayers' equity were understated by £0.850 million and net expenditure was understated by £0.034 million in the unaudited single entity accounts.</p>  | <p>Management agreed to amend the accounts to correct this misstatement. A prior period adjustment has been included in the 2020/21 accounts.</p> <p>We are content with the accounting treatment in the 2020/21 accounts.</p> <p><b>Recommendation 3</b></p>  |
| <p><b>7. Event after reporting period - increase in provision for reinstatement of the funicular</b></p> <p>The unaudited accounts included a provision of £15.1 million for the estimated costs of reinstatement of the funicular. In August 2021, HIE announced that the completion of the funicular reinstatement works would be delayed resulting in additional costs.</p>   | <p>Although the full financial impact of this delay is not yet known, management has updated the accounts to reflect its best estimate at the date the accounts were certified.</p> <p>The amendment increased net expenditure and provisions and reduced taxpayers' equity by £2 million.</p> <p>An 'events after the reporting period' disclosure has also been included in the annual report and accounts.</p> <p>We are content with the accounting adjustments and disclosures.</p> |

Source: Audit Scotland

## The financial statements were adjusted to reflect all of our audit findings and information received after the reporting period resulting in an increase in group net liabilities of £3 million

21. Presentational and monetary adjustments to the accounts identified during the audit were discussed with management who agreed to amend the financial statements.

**22.** There were three material adjustments to the annual accounts presented for audit (items 4, 5 and 6 in [Exhibit 2](#)). The adjustments reflected the full extent of the potential misstatement for items 1, 2, 4, 5 and 6 and so further audit procedures were not required. In response to item 3, we reviewed other non-current asset additions and considered the findings from our review of significant journal entries. This did not identify any other issues and so we concluded that this misstatement was an isolated incident.

**23.** The accounts were also updated to reflect information received after the reporting period (item 7). We have reviewed the basis for management's revised estimate and concluded that it reflects the best information available at the date the accounts were authorised for issue.

**24.** The net effect of the adjustments identified during the audit and processed by management was to increase HIE's single entity and group net expenditure by £2.1 million and £2 million respectively, increase other comprehensive expenditure by £0.030 million and increase net liabilities by £2.1 million and £3 million respectively.

**25.** It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality. There are no unadjusted errors to report, and management have adjusted all identified misstatements above our reporting threshold.

## **Other matters arising from the audit of the financial statements**

### **Controls over the work of HIE's management experts and service organisation could be improved**

**26.** HIE relies on external management experts (professional valuers and actuaries) to provide information that is subsequently included in the annual report and accounts.

**27.** As part of our audit, we review the work of management experts and did not identify any issues with the reliability of the information they provided. We also considered the controls HIE has in place over the expert's work and concluded that there is scope for improvement. In particular, management should review expert reports and confirm that these provide a satisfactory basis for disclosures in the accounts.

**28.** HIE also uses a property management company to manage its rental portfolio. When an entity uses a service organisation (property management company) we are required to obtain sufficient appropriate evidence to assess the risk of material misstatement in the accounts.

**29.** As part of our audit, we obtained an understanding of the services provided by the service organisation, and the controls in place at HIE and within the service organisation. Controls within HIE are not evidenced and so we could not test these. Instead, we substantively tested a sample of property income transactions to confirm that this income stream was not materially misstated. Our testing did not identify any issues. Management could strengthen the assurances it obtains from its service organisation by requesting a service

auditor report, and by evidencing the controls it has in place to ensure the completeness and accuracy of property income.

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## Recommendation 2

HIE should review reports from its management experts and confirm that these provide a satisfactory basis for disclosures in the accounts.

Controls over the completeness and accuracy of property income should be evidenced and HIE should consider requesting a service auditor report from its property managers.

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## Finance team capacity has increased, but accounting for complex areas still requires improvement

**30.** Last year we noted the increase in the finance team's capacity. As part of our audit this year we considered the impact these new posts have had on the team's financial skills and capacity.

**31.** There is some evidence that the new posts have improved the finance team's capacity. Responses to audit queries were provided promptly and the format of the cash flow statement was revised in response to last year's audit recommendation. However, we have yet to see significant improvement in accounting for complex areas such as capital accounting, Financial Transactions, and investments. Examples of the more significant matters arising from our audit of these areas are set out in [Exhibit 2](#).

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## Recommendation 3

HIE senior management should consider how to develop the required skills and experience of finance staff to ensure complex areas are properly reflected in the annual report and accounts

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## Some progress was made on prior year recommendations

**32.** HIE has made progress in implementing our prior year audit recommendations. However, responses to some recommendations remain ongoing. For actions not yet implemented, revised responses and timescales have been agreed with management, and are set out in [Appendix 1](#).

## 2. Financial management

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

### Main judgements

Financial management arrangements were effective and HIE remained within its overall grant in aid budget for 2020/21.

HIE approved more than £43 million of Covid-19 related funding in 2020/21, of which £25 million was paid by Scottish Enterprise. Appropriate measures were in place to reduce the risk of fraudulent or erroneous payments.

HIE successfully adapted its internal controls to meet the challenges of operating under Covid-19.

### HIE operated within its revised budget in 2020/21

**33.** HIE's main financial objective is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers. HIE and its group reported an outturn of £79.3 million for 2020/21 against a resource budget of £80.7 million, an underspend of £1.4 million. HIE's financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 3](#)

### Exhibit 3

#### Performance against DEL in 2020/21

| Performance            | Initial budget<br>£000 | Autumn Budget Review<br>£000 | Spring Budget Review<br>£000 | Final Budget<br>£000 | Outturn<br>£000 | Over/(under) spend<br>£000 |
|------------------------|------------------------|------------------------------|------------------------------|----------------------|-----------------|----------------------------|
| Resource DEL           | 25,495                 | 659                          | 12,110                       | 38,264               | 37,142          | (1,122)                    |
| Capital DEL            | 25,500                 | 4,700                        | 5,118                        | 35,318               | 41,042          | 5,724                      |
| Financial Transactions | 2,000                  | -                            | -                            | 2,000                | 60              | (1,940)                    |
| Non-Cash DEL           | 5,095                  | -                            | -                            | 5,095                | 995             | (4,100)                    |
| Total DEL              | 58,090                 | 5,359                        | 17,228                       | 80,677               | 79,239          | (1,438)                    |

Source: HIE Grant in Aid letters issued by Scottish Government, HIE's 2020/21 annual report and accounts

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## **HIE received additional grant in aid funding totalling £22.6 million during the year**

**34.** HIE had an initial grant in aid budget of £58.1 million. As shown in [Exhibit 3](#) above, there was a significant increase in Scottish Government funding over the course of the year. The most significant elements of the changes in HIE's budget were:

- additional RDEL allocation for the anticipated losses for HIE's subsidiary, Cairngorm Mountain (Scotland) Limited (£2.5 million), for funding of Covid-19 business support schemes (£9.8 million) and for expected credit losses (£1.5 million)
- additional CDEL allocation in respect of funding for Wave Energy Scotland (£7.5 million), the Cairngorm funicular reinstatement (£1.1 million) and the EMEC Hydrogen Demonstration project (£2.8 million). This was partially offset by £3.9 million of CDEL which HIE returned following the completion of the Digital Scotland Superfast Broadband programme.

**35.** In addition, the Scottish Government agreed that HIE could overspend its CDEL allocation by up to £6 million including funding to support HIE-designed Covid support schemes (see [Exhibit 4](#) for details) and to accelerate other projects which were due to be started in 2021/22.

## **Effective arrangements are in place for budget monitoring**

**36.** The Board approved the draft 2020/21 budget in April 2020. The budget was subsequently revised to take account of changes to budget requirements and income and expenditure projections due to Covid-19.

**37.** In April 2020, the Scottish Government issued an interim letter of guidance to HIE and the other enterprise and skills bodies. This acknowledged the need to deliver existing contractual commitments, but all other resources should be prioritised to meet the emerging fiscal, economic, and social challenges posed by Covid-19.

**38.** Senior management and the Board continued to receive regular and appropriate information on HIE's financial position during the year.

## **HIE awarded £43.6 million of Covid-19 related business and community support grants**

**39.** HIE worked with partners including other enterprise agencies, Lottery and Scottish Government to administer Covid funding during the year. Over £43.6 million of Covid-19 related support grants were awarded to businesses and community groups within the Highlands and Islands to help them manage the financial impacts of the pandemic. This included Pivotal Enterprise Resilience Fund (PERF) and Hardship payments totalling £25 million which were appraised and recommended by HIE. In line with the arrangements agreed with

Scottish Government, these payments were made by Scottish Enterprise and so are not included in HIE's expenditure.

**40.** The Covid-19 related business support grants included national funds such as the Hotel Support Programme, Scottish Wedding Industry Fund, Snowsport Programmes, Community Recovery Fund, and Supporting Community Fund. HIE also created and administered its own business and community support funds. The overall position is summarised in [Exhibit 4](#)

#### **Exhibit 4**

##### **Covid-19 schemes approved by HIE in 2020/21**

|  | <b>Number of applications approved</b> | <b>Total approved (£m)</b> | <b>Total expenditure (£m)</b> |
|--|--|----------------------------|-------------------------------|
| <b>Supporting Communities Fund</b>   | 156                                    | <b>3.8</b>                 | <b>3.5</b>                    |
| <b>Communities Recovery Fund</b>   | 87                                     | <b>1.5</b>                 | <b>1.5</b>                    |
| <b>Hotel Support Programme</b>   | 17                                     | <b>3.3</b>                 | <b>3.3</b>                    |
| <b>Scottish Wedding Industry Fund</b>  | 259                                    | <b>2.2</b>                 | <b>2.2</b>                    |
| <b>Snowsport Programme 1</b>   | 3                                      | <b>1.7</b>                 | <b>1.7</b>                    |
| <b>Snowsport programme 2</b>   | 5                                      | <b>1.9</b>                 | <b>1.9</b>                    |
| <b>Pivotal Enterprise Resilience Fund (PERF)*</b>                              | 371                                    | <b>20.1</b>                | <b>20.1</b>                   |
| <b>Creative, Tourism and Hospitality Enterprises Hardship Fund (Hardship)*</b> | 463                                    | <b>4.9</b>                 | <b>4.9</b>                    |
| <b>Restart and Recovery - Digital Enablement Grant 2020 – 21**</b>             | 207                                    | <b>2.6</b>                 | <b>1.7</b>                    |
| <b>Young Company Capital Investment Grant**</b>                                | 67                                     | <b>1.1</b>                 | <b>0.9</b>                    |
| <b>Community-led Tourism Infrastructure**</b>                                  | 55                                     | <b>1.6</b>                 | <b>1.5</b>                    |
| <b>Island Green Recovery Programme**</b>                                       | 11                                     | <b>0.7</b>                 | <b>0.4</b>                    |
| <b>Destination Management Organisation Recovery Funding**</b>                  | 6                                      | <b>2.1</b>                 | <b>0.04</b>                   |

|              |       |             |             |
|--------------|-------|-------------|-------------|
| <b>Total</b> | 1,707 | <b>47.5</b> | <b>43.6</b> |
|--------------|-------|-------------|-------------|

\* PERF and Hardship paid by Scottish Enterprise (payments not reflected in HIE's expenditure)

\*\* HIE designed business support funds

Source: Highlands and Islands Enterprise Annual Accounts and Report 2020/21

**41.** HIE administers grants to companies and organisations as part of its routine business and it was able to use existing systems and processes to deliver the Covid-19 schemes. These schemes represented a significant increase in the volume and value of grants issued and HIE modified its governance arrangements and systems of control accordingly.

**42.** Overall, HIE implemented adequate systems for recording and processing Covid-19 grant transactions, and to reduce the risk of fraudulent or erroneous payments. We noted, however, that each of the Covid-19 grants required an element of self-declaration from grant applicants. For some of the grants, this included a requirement to confirm that they did not receive any other Covid-19 funding. We will continue to monitor HIE's administration of Covid-19 grant payments as part of our 2021/22 audit.

### Financial systems of internal control operated as expected

**43.** We reported the findings from our review of internal controls in our management report, presented to the Risk and Assurance Committee in June 2021. We concluded that the key controls within HIE's main financial systems continued to operate as intended during 2020/21. We did not identify any weaknesses in these controls as a result of the move to homeworking in response to the Covid-19 pandemic.

**44.** No significant internal control weaknesses were identified during the audit which could affect HIE's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

### Internal audit remains effective

**45.** We reviewed HIE's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent to which we could use the work of internal audit.

**46.** Internal audit is provided by an in-house team supported by additional resources provided by a firm of accountants. Specialist IT audit services are provided by an independent third party on behalf of HIE and their partners in Enterprise Information Services (EIS) (the shared IT arrangement with Skills Development Scotland (SDS), Scottish Enterprise (SE) and South of Scotland Enterprise (SOSE)).

**47.** Our review concluded that HIE's internal audit arrangements are effective. We placed reliance on internal audit's testing of significant transactions and Covid-19 grant expenditure and its work on the certificates of assurance which support the governance statement. This works supports our audit opinion.

## **Standards of conduct and arrangements for the prevention and detection of fraud and error are appropriate**

**48.** HIE is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery, and corruption. Furthermore, the Board is responsible for ensuring that its affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

**49.** We reviewed the arrangements in place to maintain standards of conduct including the codes of conduct in place for both staff and Board members. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

**50.** We concluded that appropriate arrangements are in place for the prevention and detection of fraud, error, and irregularities. We are not aware of any specific issues that we need to bring to your attention.

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# 3. Financial sustainability

Financial sustainability looks forward to the medium and long term to consider whether a body is planning effectively to continue to deliver its services

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## Main judgements

HIE approved a balanced budget for 2021/22 but continues to face significant financial challenges and uncertainties, not least related to the funding of activities on Cairngorm Mountain and reinstatement of the funicular railway.

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### HIE approved a balanced budget for 2021/22

**51.** HIE's 2021/22 budget was approved by the Board as part of the 2021 operating plan in April 2021. The approved budget shows that HIE plans to spend £114.8 million (revenue and capital) in 2021/22. This will be funded by £101.6 million grant in aid from the Scottish Government, and revenue (£2.4 million) and capital (£2.9 million) receipts. As in previous years, the approved budget includes an element (£7.9 million) of 'over-programming' which HIE will manage through expected slippage in spending plans and additional funding requests.

**52.** The 2021/22 budget is higher than the final 2020/21 outturn. This is mostly due to the inclusion of a number of large capital projects (see budget assumptions below).

### HIE continues to face significant financial risks and uncertainties in 2021/22

**53.** HIE continues to face significant financial risks and uncertainties. The approved budget for 2021/22 includes key assumptions in relation to these:

- key capital projects (including Space Hub Sutherland, WES, and Cairngorm (other priority capital)) will be funded in full by the Scottish Government in 2021/22. Together key projects account for £20.9 million of HIE's capital budget for 2021/22. Scottish Government funding for these major projects has not yet been confirmed
- the shortfall (£1.9 million) between the funding for reinstatement of the funicular due from the Scottish Government and the anticipated costs payable in 2021/22 can be managed by slippage within HIE's capital programme or will require additional funding from the Scottish Government. The £1.9 million excludes the financial impact of the announcement in August 2021 that completion of the works will be delayed until late 2022. The position at Cairngorm is considered further in the following section of our report

- the impact of the proposed new methodology for calculating non-recoverable VAT will not exceed £2.1 million
- the pay award will be absorbed and efficiencies on administrative costs built into budgets will be delivered
- only legally committed projects have been included in the budget with the exception of expenditure resulting from the green jobs fund, Financial Transactions, and Covid-consequential funding.

**54.** Work is also due to start on development of Nigg East Quay. Funding of £5.4 million was carried forward from 2020/21 with the agreement of the Scottish Government and has been included in the 2021/22 budget.

**55.** HIE acknowledges that it remains challenging to manage these financial pressures alongside the ongoing uncertainty caused by Covid-19. It will monitor progress relative to the key assumptions applied in producing its budget for 2021/22.

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## Recommendation 4

HIE should keep its financial plans under close review during 2021/22 so that it is able to take early and informed decisions which address the financial challenges it faces.

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### Reinstatement of the Cairngorm funicular will cost more than expected due to Covid-19, extreme weather and technical challenges

**56.** On 9 October 2020, HIE and the Scottish Government announced that £20 million would be invested in Cairngorm to sustain the resort as a year-round attraction and important national asset. Shortly thereafter construction work began on the reinstatement of the funicular which has been out of service since September 2018. Reinstatement works (including professional fees) totalled £2.4 million in 2020/21.

**57.** Progress has been hampered by Covid-19 restrictions and extreme weather. In August 2021, HIE announced that due to unprecedented circumstances and unforeseen technical challenges, completion of the funicular reinstatement works will not be achieved by winter 2021/22 as originally anticipated. The financial impact of this delay is not yet fully known. The annual accounts include a provision of £17.1 million for reinstatement of the funicular (after deduction of the £2.4 million of costs incurred in year), an increase of £2.5 million from the previous year.

**58.** HIE has also approved up to £780,000 for an extensive refurbishment of the Ptarmigan building that sits on the plateau and includes the UK's highest restaurant, a shop, exhibition space and viewing platforms. The refurbishment started at the end of August and is due to be completed by the end of 2021.

**59.** The masterplan for the Cairngorm Estate was published in June 2021. Cairngorm Mountain will continue to put strain on HIE's finances and its plans for financial sustainability for the foreseeable future. We will continue to monitor developments.

### **HIE provided £1.7 million of funding to Cairngorm Mountain (Scotland) Limited during 2020/21**

**60.** Cairngorm Mountain resort was closed for nearly six months of the year, including over the critical winter season, due to Covid-19 restrictions. As a result, the company managing activities on Cairngorm, Cairngorm Mountain (Scotland) Limited (CMSL) which is a subsidiary of HIE, experienced a significant reduction in its business compared to the previous year. CMSL recorded a break-even position after revenue grant funding totalling £1.652 million from HIE and £0.3 million from the coronavirus furlough scheme. As a subsidiary of HIE, CMSL was not eligible to apply for funding from either of the Covid-19 Snowsports programmes.

### **HIE's pension fund deficit increased during 2020/21, and it remains a significant longer-term liability**

**61.** The 2020/21 annual accounts report that HIE's pension schemes are in deficit with liabilities exceeding assets by £60.6 million (2019/20: £42 million) resulting in group net liabilities of £37.7 million at the year end. The HIE pension scheme accounts for most of this deficit with an excess of liabilities over assets of £57.1 million as at 31 March 2021 (£38.9 million as at 31 March 2020).

**62.** The Scottish Government has provided HIE with guarantees for the local government pension schemes to cover the costs associated with any cessation event (triggered when HIE no longer has any active members in a pension scheme). This is an important safeguard as HIE is a member of three local government pension schemes with decreasing numbers of active members. The Scottish Government has also provided a guarantee which covers the HIE pension scheme liability.

**63.** The triennial valuation of the HIE pension scheme as at 5 April 2021 has recently been completed. This valuation uses a different basis to calculate the underlying deficit on the HIE pension scheme which has increased from £30 million to £39.4 million over the last three years.

**64.** HIE has previously implemented a recovery plan, including lump sum employer contributions, and increasing members' contribution rate, to address this deficit on its pension scheme. HIE made a lump sum payment of £0.250 million during 2020/21 to reduce its pension deficit.

**65.** Triennial valuations of all of the local government pension schemes as at 31 March 2020 have been concluded and these form the basis of employer contribution rates with effect from 1 April 2021.

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# 4. Governance and transparency

The effectiveness of scrutiny and oversight, and transparent reporting of information

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## Main judgements

Appropriate governance arrangements were in place during 2020/21.

Governance arrangements for financial write-offs require improvement.

The Performance Report was revised to provide a more balanced picture of performance. We are satisfied that the audited performance report now meets the requirements of the FReM.

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## HIE had appropriate governance arrangements in place during 2020/21

**66.** HIE is governed by a Board that is accountable to Scottish Ministers. As at 31 March 2021, the Board consisted of the Chair, ten non-executive members, and the Chief Executive. In July 2021 the Chief Executive resigned and an interim Chief Executive was appointed. Recruitment is ongoing to appoint a permanent replacement.

**67.** There were six Board meetings in 2020/21. The Board is supported by two sub committees: risk and assurance (RAC), and remuneration. HIE also established two sub-groups to consider issues related to Cairngorm Mountain, and Space. The Cairngorm sub-group met 8 times and the Space sub-group met 9 times during 2020/21.

**68.** The RAC met four times during 2020/21. Agendas follow a standard format and papers are circulated to members in advance, allowing adequate time for members to review. We attend all RAC meetings and are satisfied that members provide appropriate scrutiny of submitted reports.

**69.** In March 2020 HIE established an Investment Committee to '*provide a forum for increased strategic discussion and to support consistent approaches to implementation across HIE*'. During 2020/21 the Investment Committee was made up of members of the leadership team and area managers. It met regularly, sometimes daily, during the year to approve applications for Covid grants and to ensure applications were consistently assessed. As part of our testing of Covid grants we considered the work of the committee and concluded that it played a key role in the governance of Covid funds.

**70.** During the year, the Board provided additional oversight of Covid payments including approving HIE's involvement in the individual schemes. Regular updates on additional funding received and payments made were provided to the Board and the RAC during the year.

### **Governance arrangements for write-offs require improvement**

**71.** The unaudited accounts included write-offs of debtor balances totalling £0.844 million. The majority of these related to businesses which were in administration or where HIE had exhausted all its recovery options. The remaining £0.330 million related to debtors for EU funding and these were reassessed and reinstated in the audited accounts.

**72.** In June 2021 management submitted a paper to the Risk and Assurance Committee summarising the write-offs for the 2020/21 financial year. This paper was also presented to the August 2021 meeting of the Board as Board approval is required for all individual write-offs over £0.250 million and an aggregate value in excess of £0.5 million.

**73.** We compared the write-offs included in the unaudited accounts to those set out in the RAC/Board paper and noted that only £15,000 of the £0.844 million written-off in the unaudited accounts had been reported to the RAC and Board. There were two write-offs within the unreported balance that exceeded £0.250 million and, therefore, required Board approval. These were £0.305 million for rent due from Burntisland Fabrications Limited and £0.330 million of EU funding. We have been advised that these write-offs were not included in the summary committee paper as management had not yet written the detailed paper for each write-off.

**74.** We are satisfied that the write-offs reflected in the audited accounts relate to businesses that are in administration or where HIE has exhausted all recovery options. The Director of Finance and Corporate Services has also confirmed that he is content that these debts are not recoverable. We would, however, expect the annual write-offs paper presented to the Board to include all write-offs included in the annual report and accounts. We would also expect Board approval to be obtained in line with HIE's delegated limits as part of the annual report and accounts preparation processes.

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## **Recommendation 5**

HIE should review its internal procedures for write-offs. It should ensure that all write-offs recognised in the accounts are included in the annual write-offs paper submitted to the Board, with approval sought for all write-offs over £0.250 million as required.

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## The Performance Report was revised to provide a more balanced picture of performance

**75.** In addition to the opinion on the performance report covered in [section 1](#) of our Annual Audit Report, we also consider the qualitative aspects of HIE's Performance Report. The Performance Report should provide information on a body, its main objectives and the principal risks faced. It should provide a fair, balanced, and understandable analysis of a body's performance as well as helping stakeholders understand the financial statements.

**76.** Last year we reported that HIE had improved the presentation and content of its Performance Report but that there was scope to provide a more balanced picture of performance. This year, we again noted the need for balance in performance reporting. We also noted a need to provide information which better assists understanding of how information in the annual report relates to the main financial statements. We discussed a range of matters with management who agreed to update the report. The revised narrative provides a more complete picture of HIE's challenges, activities, and performance throughout 2020/21. We concluded that the audited performance report meets the requirements of the Financial Reporting Manual (FReM).

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### Recommendation 6

HIE should review the content and presentation of its performance report against Annex 5 of the FReM and Audit Scotland's good practice guide. In addition, HIE should review how it assists understanding of how financial information in the annual report relates to the main financial statements.

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## HIE continues to improve its cyber security arrangements

**77.** Public bodies should have good provision for managing data and monitoring information security. They should also have demonstrable capacity and capability for responding to increasing risks to cyber security. Threats are increasing as organisations deliver more services online. Public bodies should have risk assessment processes in place for recording activities and learning including the cost impact of responding to a cyber-attack.

**78.** Information technology services for HIE are mostly managed by the Enterprise Information Services (EIS). The EIS Partnership Board provides the strategic oversight of the EIS partnership (also involving Skills Development Scotland, South of Scotland Enterprise, and Scottish Enterprise) which has been in place for just over ten years. EIS carried out a Cyber Essentials internal assessment and obtained certificates for this in February 2021 and May 2021. The partnership was also assessed externally and obtained a Cyber Essentials Plus certificate in June 2021.

**79.** The partnership has appointed a specialist information systems internal auditor for EIS. We reported last year that internal audit's report on the EIS cyber security in September 2019 was graded 4 (the second highest priority for attention) with a recommendation to carry out a cyber maturity assessment. EIS have implemented all but one of the report recommendations. The recommendation relating to the development of a long-term Security Operations Centre strategy is ongoing.

**80.** Internal audit carried out further work in this area in 2020/21 including developing and implementing an overall assurance map and completing a review of the EIS security operations centre. The latter received a grading of 3 (medium risk) and resulted in 17 recommendations, one of which was rated as critical. Internal audit will continue to maintain an appropriate level of focus on cyber preparedness. The risk and potential impact from cyber activity and related penetration actions will continue to challenge organisations and EIS should ensure that it continues to make improvements to its cyber security arrangements.

**81.** In addition to the systems hosted by EIS HIE have a number of internally hosted systems. Work was undertaken in 2020/21 and continues in 2021/22 to improve the cyber security and business continuity for these systems.

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# 5. Value for money

Using resources effectively and continually improving services

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## Main judgements

HIE has an appropriate and effective best value framework in place.

Performance monitoring continued throughout 2020/21 although performance targets were not set due to Covid-19. There was an increase in performance against the majority of HIE's primary outcome measures despite the pandemic.

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### HIE has developed an appropriate Best Value framework

**82.** [Ministerial guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

**83.** The Interim Chief Executive of HIE is the designated Accountable Officer. A range of processes are in place to help the Accountable Officer demonstrate best value. The annual report and accounts outline HIE's approach to best value. This includes:

- sound and developing corporate governance arrangements to reflect the changing roles and structures within the organisation
- the development of a three-year strategic plan together with an annual business plan
- regular monitoring of budgets and resources
- a systematic approach to risk management
- regular monitoring of the achievement of outcomes.

**84.** We concluded that HIE has an appropriate best value framework in place.

### HIE did not publish a 2020/21 operating plan

**85.** HIE did not produce a 2020/21 operating plan. It did not publish target ranges for key performance indicators due to the uncertainty caused by the Covid-19 pandemic and its impact on the Scottish economy. This was in line with Scottish Government guidance.

**86.** HIE continued to monitor performance throughout 202/21 and there was an increase in performance against the majority of its primary outcome measures compared to last year. There was a reduction in performance against two of its outcome measures - planned international export sales (reduced from £33.1 million to £19.1 million), and average wage of jobs supported (reduced from £28,058 to £22,727 per annum). HIE attributes these reductions to the impact of the pandemic, the uncertainty caused by the exit from the EU (in respect of the international sales reduction) and its focus on the delivery of Covid-19 support.

### **National performance audit reports**

**87.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Although there were no reports published in 2020/21 which were of direct interest to HIE, there were others with some wider relevance. These are set out in [Appendix 3](#).

# Appendix 1. Action plan 2020/21

## 2020/21 recommendations

| Issue/risk   | Recommendation   | Agreed management action/timing   |
|--|--|---|
| <p><b>1. Capital accounting</b></p> <p>Last year we reported that HIE needed to develop its understanding of capital accounting. This year we identified more issues with how HIE accounts for non-current assets and capital receipts.</p> <p>Risk: the annual accounts do not comply with accounting standards and policies. Significant audit input is required to ensure the accounts are not materially misstated resulting in additional audit fees.</p>                   | <p>HIE finance staff should improve its understanding of capital accounting, including accounting for revaluation and classification of non-current assets.</p> <p><a href="#">Exhibit 2</a>, points 1 to 4</p>  | <p>We will consider the points raised in line with the discussions undertaken during the audit and review our capital accounting processes.</p> <p><b>Responsible officer:</b><br/>Head of Financial Services</p> <p><b>Agreed date:</b><br/>31 March 2022</p>  |
| <p><b>2. Use of management experts and service organisation</b></p> <p>HIE relies on external management experts (professional valuers and actuaries) to provide information that is subsequently included in its annual report and accounts. It also uses a service organisation to manage its property portfolio.</p> <p>We concluded that there is scope to improve the controls management has put in place to ensure the reliability of the information provided by the</p> | <p>HIE senior management should review reports from its management experts and confirm that these provide a satisfactory basis for the disclosures included in the accounts.</p> <p>Controls over the completeness and accuracy of property income should be evidenced and consideration given to requesting a service auditor report from their property managers.</p> <p><a href="#">Paragraphs 26 to 29</a></p> | <p><u>Actuarial Advice</u></p> <p>HIE receives actuarial advice each year in relation to valuations from two different actuarial advisors (one for the Local Government Pension Scheme and one for the HIE Pension Scheme). This allows some comparison of assumptions and for the 2020/21 accounts we expanded this to compare with assumptions provided to other enterprise agencies. It is proposed that we retain this comparative check on an ongoing basis.</p> |

| Issue/risk   | Recommendation | Agreed management action/timing   |
|--|----------------|---|
| <p>management experts and the completeness and accuracy of property income.</p> <p>Risk: information is included in the accounts which is not in accordance with management's assessment and expectations.</p> |                | <p>Every three years HIE receives a valuation on a different basis, which does not feature directly in the accounts, but may be mentioned in the Annual Report. This valuation is provided to the Scheme Trustees, who scrutinise it in some detail. HIE is party to this scrutiny as an attendee at Trustees' meeting. In 2021 the Scheme Actuary provided specific training on the interpretation of valuations that was attended by the Trustees and the Director of Finance and Corporate Services. Our view is that this already provides a reasonable level of control.</p> <p><b>Responsible officer:</b><br/>Director of Finance &amp; Corporate Services</p> <p><b>Agreed date:</b><br/>Ongoing</p> <p><u>Professional Valuation Services</u></p> <p>The Head of Property &amp; Infrastructure will review the draft and final annual Asset Valuation processes and values to ensure completeness and accuracy.</p> <p><b>Responsible Officer:</b><br/>Head of Property &amp; Infrastructure</p> <p><b>Agreed date:</b><br/>April 2022 (dependent on when final valuation is received)</p> |

| Issue/risk  | Recommendation   | Agreed management action/timing   |
|---|--|---|
|   |  | <p><u>Property Management Services</u></p> <p>Potential for a service audit report will be considered by HIE's Property and Internal Audit Teams</p> <p><b>Responsible Officer:</b><br/>Property Development Manager with Audit and Assurance Manager</p> <p><b>Agreed date:</b><br/>31 December 2021 (for recommendation to HIE Management).</p> |
| <p><b>3. Finance team capacity</b></p> <p>There is some evidence that the new posts have improved the finance team's capacity. However, we have yet to see significant improvement in accounting for complex areas such as capital accounting, Financial Transactions, and investments.</p> <p>Risk: the annual report and accounts submitted for audit are materially misstated or require significant adjustment.</p> | <p>HIE senior management should consider how to develop the required skills and experience to ensure complex areas are appropriately reflected in the annual report and accounts.</p> <p><a href="#">Paragraphs 30 &amp; 31</a></p>                        | <p>We will undertake a further review of the Finance team's skills and capacity in advance of the start of the annual accounts process for 2021/22.</p> <p><b>Responsible officer:</b><br/>Director of Finance &amp; Corporate Services</p> <p><b>Agreed date:</b><br/>31 March 2022</p>  |
| <p><b>4. Financial sustainability</b></p> <p>HIE faces significant financial risks and uncertainties in 2021/22 and the approved budget includes key assumptions in relation to these. HIE acknowledges that it will be challenging to manage these financial pressures alongside the continuing uncertainty caused by Covid-19.</p> <p>Risk: HIE is unable to deliver all of its financial commitments or meet</p>     | <p>HIE should continue to keep its financial plans under close review during 2021/22 so that it is able to take early and informed decisions on options for dealing with the financial challenges it faces.</p> <p><a href="#">Paragraphs 53 to 55</a></p> | <p>Agreed</p> <p><b>Responsible officer:</b><br/>Director of Finance &amp; Corporate Services</p> <p><b>Agreed date:</b><br/>Ongoing during 2021/22</p>   |

| Issue/risk  | Recommendation  | Agreed management action/timing  |
|---|---|--|
| performance targets within its existing resource allocation.  |   |  |
| <p><b>5. Governance of write-offs</b></p> <p>The 2020/21 accounts include write-offs which have not been notified to the Board and Board approval has not been obtained for individual write-offs which exceed £0.250 million as required by HIE's Delegated Levels of Authority document.</p> <p>Risks: write-offs are not approved in line with HIE's delegated limits. The Board are not aware of all write-offs processed through the accounts.</p> | <p>HIE should review its internal procedures for write-offs and ensure that all write-offs recognised in the accounts are included in the annual report to the Board and approval sought for all write-offs over £0.250 million as set out in HIE's Delegated Levels of Authority document.</p> <p><a href="#">Paragraphs 71 to 74</a></p>                            | <p>Agreed</p> <p><b>Responsible officer:</b><br/>Director of Finance &amp; Corporate Services</p> <p><b>Agreed date:</b><br/>31 May 2022</p>           |
| <p><b>6. Performance Report</b></p> <p>This year we again noted a lack of balance in performance reporting. We also noted a need to assist understanding of how the financial performance information relates to the main financial statements.</p> <p>Risk: HIE does not communicate its performance effectively to its stakeholders.</p>  | <p>HIE should review the content and presentation of its performance report against Annex 5 of the FReM and Audit Scotland's good practice guide. In addition, HIE should review how it assists understanding of how financial information contained in the annual report relates to the main financial statements.</p> <p><a href="#">Paragraphs 75 &amp; 76</a></p> | <p>Agreed</p> <p><b>Responsible officers:</b><br/>Head of Communications<br/>Head of Financial Services</p> <p><b>Agreed date:</b><br/>31 May 2022</p> |

## Follow-up of prior year recommendations

| Issue/risk  | Recommendation  | Agreed management action/timing  |
|---|---|--|
| <p><b>b/f 1. Presentation of financial statements</b></p> <p>During the audit we highlighted areas where the presentation and content of the financial statements could be improved. Examples include the cash flow</p> | <p>HIE should review the presentation of the financial statements, including the cash flow statement and parliamentary accountability report, to ensure they are clear, concise, and internally consistent.</p> | <p><b>Ongoing</b></p> <p>The format of the cash flow statement was reviewed and simplified during 2020/21. Review of the working paper to support the 2020/21 disclosures identified a number of errors which were</p> |

| Issue/risk  | Recommendation  | Agreed management action/timing  |
|---|---|--|
| <p>statement and the financial performance disclosures in the parliamentary accountability report.</p> <p>Risk: users are unable to make best use of and fully understand the financial statements.</p>   |   | <p>corrected in the audited accounts.</p> <p>There were no changes to the financial performance disclosures in the parliamentary accountability report.</p> <p>Refer to <a href="#">Recommendation 6</a></p>                           |
| <p><b>b/f 2. Financial sustainability</b></p> <p>HIE faces significant financial risks and uncertainties in 2020/21 and the approved budget includes key assumptions in relation to these. HIE acknowledges that it will be challenging to manage these financial pressures alongside the uncertainty caused by Covid-19</p> <p>Risk: HIE is unable to deliver all its financial commitments or meet performance targets within its existing resource allocation.</p> | <p>HIE should continue to keep its financial plans under close review during 2020/21 so that it is able to take early and informed decisions on options for dealing with the financial challenges it faces.</p> | <p><b>Completed</b></p> <p>This risk has been superseded by action point 4 above.</p>  |
| <p><b>b/f 3. Internal control arrangements</b></p> <p>The scale and pace of change as a result of Covid-19 poses a risk to HIE's governance arrangements.</p> <p>Risk: there is a risk that key financial controls do not operate as intended due to new ways of working</p>  | <p>HIE should ensure that internal controls remain effective during this period of uncertainty and new ways of working.</p>   | <p><b>Completed</b></p> <p>We undertook walkthrough testing of key controls and concluded that these were operating as intended and had been updated to reflect the new working arrangements such as use of electronic signatures.</p> |
| <p><b>b/f 4. Performance Report narrative</b></p> <p>The performance report narrative could be improved to ensure it is balanced and transparent.</p> <p>Risk: there is a risk that HIE does not communicate its</p>  | <p>HIE should review the content and presentation of its performance report against Annex 5 of the FReM and Audit Scotland's good practice guide.</p>   | <p><b>Ongoing</b></p> <p>This year we again noted the lack of balance in performance reporting in the annual report and accounts presented for audit. Refer to paragraphs 75 &amp; 76 for details.</p>                                 |

| Issue/risk   | Recommendation   | Agreed management action/timing  |
|--|--|--|
| performance effectively to its stakeholders.   |  | Refer to <a href="#">Recommendation 6</a>  |
| <p><b>b/f 5. Accounts preparation process</b></p> <p>We identified a number of errors and omissions in how HIE reflected transactions within its financial statements.</p> <p>Risk: the accounts do not give a true and fair view of HIE and its group’s financial position and net expenditure.</p> | <p>Accounts preparation processes should be reviewed prior to the preparation of the 2020/21 annual report and accounts</p>  | <p><b>Ongoing</b></p> <p>This year we identified further areas where year-end processes require to be improved. Refer to <a href="#">Exhibit 2</a> for details.</p> <p>Refer to <a href="#">Recommendation 3</a></p> |
| <p><b>b/f 6 Cyber security</b></p> <p>Cyber essentials have not yet been achieved.</p> <p>Risk: key systems are not resilient enough to deal with a cyber-attack.</p>  | <p>HIE should continue to work with its EIS partners to ensure cyber essentials is achieved. This will be further developed as the partnership moves towards cyber catalyst recognition.</p> | <p><b>Completed</b></p> <p>Cyber Essentials Plus accreditation was achieved in June 2021. Refer to paragraphs 77 to 81 for details.</p>  |

# Appendix 2. Significant audit risks

The table below sets out the audit risks we identified on the 2020/21 audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the financial statements and those relating to our wider responsibility under the [Code of Audit Practice 2016](#).

## Risks of material misstatement in the financial statements

| Audit risk   | Assurance procedure   | Results and conclusions   |
|--|---|---|
| <p><b>1. Management override of controls</b></p> <p>International Auditing Standards require that audits are planned to consider the risk of material misstatement in the financial statements caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of fraud due to the management override of controls.</p>   | <p>Testing of journal entries. Review of accounting estimates.</p> <p>Testing of accruals and prepayments.</p> <p>Cut-off testing, to ensure income and expenditure is recognised in the correct financial year.</p> <p>Evaluation of any significant transactions that are outside the normal course of business</p>   | <p><b>Results:</b> We did not identify any issues from our audit work that would indicate management override of controls affecting the year-end position.</p> <p>There were no significant transactions outside the normal course of business.</p> <p><b>Conclusion:</b> Satisfactory</p>                                  |
| <p><b>2. Risk of material misstatement caused by fraud in income recognition</b></p> <p>As set out in ISA (UK) 240, there is a presumed risk of fraud in the recognition of income.</p> <p>HIE and its group received £15 million of income from sources other than the Scottish Government in 2019/20 and expect a similar amount in 2020/21. It has also received additional income to fund Covid-19 relief initiatives.</p> | <p>Review of HIE's anti-fraud arrangements. Walkthrough and testing of controls over receivables focusing on any changes in approach resulting from Covid-19.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest audit risk including property income, EU income and Covid-19 related funding.</p> <p>Substantive cut-off testing of income to ensure that it has been recognised in the correct financial year.</p> | <p><b>Results:</b> We reconsidered this risk on receipt of the unaudited accounts and concluded that there was not a risk of material misstatement caused by fraud in income.</p> <p>Standard audit testing was undertaken on income transactions and no issues were identified.</p> <p><b>Conclusion:</b> Satisfactory</p> |

| Audit risk  | Assurance procedure  | Results and conclusions  |
|---|--|--|
| <p>The extent and nature of this income means that there is a risk that the financial statements will be misstated due to fraud in income recognition.</p>  |  |  |
| <p><b>3. Risk of material misstatement caused by fraud in expenditure</b></p> <p>As most public-sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure.</p> <p>Last year, 26% of HIE's expenditure was on grants to third parties. Since March 2020 it has been distributing Covid-19 grants to help support businesses impacted by the pandemic.</p> <p>The extent and nature of this expenditure means that there is a risk that the financial statements will be misstated due to fraud in expenditure.</p>        | <p>Review of HIE's anti-fraud arrangements.</p> <p>Walkthrough and testing of controls over payables systems focusing on any changes in approach resulting from Covid-19.</p> <p>Document and test the controls over the authorisation and payment of Covid-19 grants.</p> <p>Substantive testing of grant expenditure with reliance on internal audit's work on significant transactions and Covid-19 payments.</p> | <p><b>Results:</b> We did not identify any issues with anti-fraud arrangements.</p> <p>We undertook detailed testing of the Covid-19 grants and relied on internal audit's work on significant transactions and Covid-19 grant payments.</p> <p>No significant issues were identified from our controls or substantive testing of HIE's expenditure.</p> <p><b>Conclusion:</b> Satisfactory</p>  |
| <p><b>4. Estimates and judgements</b></p> <p>ISA 540 is concerned with the auditor's responsibilities relating to accounting estimates and related disclosures in financial statements.</p> <p>There is a significant degree of subjectivity in the measurement and valuation of land and buildings (£31m), pension liabilities (£41m), and investments (£2m). There is also a degree of estimation and judgement in accrued expenditure (£5m), accrued income (£2m) and provisions (£14m).</p> <p>This subjectivity represents an increased risk of material</p> | <p>Reviewed the work of an expert for management's professional valuers (non-current assets and pension liabilities),</p> <p>Reviewed management's assessment of the appropriateness of the assumptions used in the valuation of these assets and liabilities.</p> <p>Substantive testing of year-end balances.</p>  | <p><b>Results:</b> We reconsidered this risk on receipt of the unaudited accounts and concluded that only the valuation of land and buildings and the pension liability are at risk of material misstatement. Our work on this risk was, therefore, focussed on these areas.</p> <p>We assessed management's controls and processes for estimates and judgements, including management's experts and concluded that these could be improved.</p> <p>No significant issues were identified from our review of the year-end pensions or property valuations.</p> |

| Audit risk  | Assurance procedure   | Results and conclusions  |
|---|---|--|
| <p>misstatement in the financial statements.</p>  |   | <p><b>Conclusion:</b> Satisfactory, but management's controls and processes for management's experts could be improved.</p> <p><a href="#">Recommendation 2</a></p>  |
| <p><b>5. Changes to FReM requirements for narrative reporting</b></p> <p>Last year we noted that there was scope to improve the Performance Report. This year's Government Financial Reporting Manual (FReM) includes a new chapter (Chapter 3) on lessons learned from the Government Financial Reporting Review, examples of good practice and guidance on improving narrative reporting. Chapters 5 (performance report) and 6 (accountability report) of the FReM have also been revised. There is a risk that the 2020/21 annual report and accounts do not reflect the revised FReM requirements.</p> | <p>Review of the performance and accountability reports against requirements set out in the 2020/21 FReM.</p> <p>Review of completed disclosure checklist and investigation of any areas of non-compliance.</p> | <p><b>Results:</b> We reviewed the new FReM requirements and were content that they were appropriately included in the annual accounts and report.</p> <p>As in prior years we concluded that the unaudited Performance Report did not provide a balanced picture of HIE's performance during 2020/21. Management agreed to revise the narrative to ensure the audited performance report complied with the FReM.</p> <p><b>Conclusion:</b> further work is required to ensure that performance reports presented for audit provide a balanced picture of HIE's performance.</p> <p><a href="#">Recommendation 6</a></p> |

## Risks identified from the auditor's wider responsibility under the Code of Audit Practice

| Audit risk   | Assurance procedure  | Results and conclusions   |
|--|--|---|
| <p><b>6. Governance and transparency - impact of Covid-19</b></p> <p>Since March 2020, HIE has had a key role in Scotland's response to Covid-19, supporting jobs and businesses through the distribution of Covid-19 grants. Decision making in a fast-moving environment presents a challenge for HIE and other public bodies.</p> | <p>Reviewed the extent and nature of Covid-19 grant funding provided to HIE and distributed by HIE to businesses</p> <p>Reviewed the governance and accountability arrangements for distributing Covid-19 funding, including scrutiny by the Board and steps taken to minimise fraud and error</p> | <p><b>Results:</b> We undertook detailed testing of the different Covid-19 grant products.</p> <p>We relied on internal audit's work on significant transactions and Covid-19 grant payments.</p> <p>No significant issues were identified from our controls or substantive testing of HIE's expenditure.</p> |

| Audit risk  | Assurance procedure   | Results and conclusions   |
|---|---|---|
| <p>These include maintaining good governance and controls while making decisions quickly, adapting performance measures and ensuring that anti-fraud arrangements remain robust at a time when the risk of fraud is increased. There is a risk that appropriate governance and oversight has not been applied.</p>  | <p>Reviewed the key financial controls over Covid-19-related income and expenditure</p> <p>performance targets for the efficiency and effectiveness of Covid-19 funding</p> <p>Reviewed internal audit's work on Covid-19 response and Covid-19 grants recommendations from their budget review and financial planning arrangements within the board.</p> | <p><b>Conclusion:</b> Satisfactory</p>  |
| <p><b>7. Financial sustainability</b></p> <p>HIE will have a key role to play 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 Cairngorm funicular railway, and the Spaceports development). There is a risk that HIE is unable to deliver all of its existing financial commitments and achieve its performance targets whilst supporting the recovery and renewal of the local economy.</p> | <p>Reviewed financial plans for recovery and renewal post Covid.</p> <p>Reviewed monitoring reports and the financial position at the year-end including performance against resource limits set by the Scottish Government.</p> <p>Ongoing discussions with HIE about its financial position</p>   | <p><b>Results</b> HIE underspent its revenue resource allocations (RDEL) and reported a permitted overspend on capital resource allocations (CDEL) in 2020/21.</p> <p>The 2021/22 budget contains a number of budgetary pressures and will be challenging to deliver.</p> <p><b>Conclusion:</b> given the financial pressures HIE faces in 2021/22, there is still a risk that it will be unable to deliver all of its financial commitments or achieve its performance targets within its existing resource allocations.</p> <p><a href="#">Recommendation 4</a></p> |
| <p><b>8. Governance and transparency - cyber security</b></p> <p>Organisations are increasingly threatened by cyber-attacks as evidenced by recent incidents affecting public bodies. This risk is heightened due to the impact of Covid-19 such as remote-working.</p>   | <p>Assessed progress towards improving cyber security including achieving Cyber Essentials Plus accreditation</p> <p>Consider disclosure of cyber security risk in the governance statement within the annual report and accounts.</p>  | <p><b>Results:</b> EIS partner bodies (including HIE) achieved Cyber Essentials Plus accreditation in June 2021. While this is a positive development, this is an area requiring ongoing attention with an internal audit report on the new security operations centre raising 17 new recommendations.</p> <p><b>Conclusion:</b> Satisfactory, but further work is required to</p>  |

| Audit risk   | Assurance procedure | Results and conclusions   |
|--|---------------------|---|
| <p>HIE has a shared Enterprise Information Services (EIS) IT arrangement with Skills Development Scotland (SDS) and Scottish Enterprise (SE). HIE is currently working to strengthen its cyber security arrangements including implementing improvement actions identified during the recent cyber security maturity assessment. There is a risk that a cyber-attack could disrupt HIE's systems, including its key financial systems.</p> |                     | <p>address internal audit recommendations and to maintain good arrangements to offset the threat of a cyber-attack.</p> |

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# Appendix 3. Summary of 2020/21 national performance reports

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## April

[Affordable housing](#)

## June

[Highlands and Islands Enterprise: Management of Cairngorm mountain and funicular railway](#)

[Local government in Scotland Overview 2020](#)

## July

[The National Fraud Initiative in Scotland 2018/19](#)

## January

[Digital progress in local government](#)

[Local government in Scotland: Financial overview 2019/20](#)

## February

[NHS in Scotland 2020](#)

## March

[Improving outcomes for young people through school education](#)

# Highlands and Islands Enterprise

## 2020/21 Annual Audit Report

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
T: 0131 625 1500 E: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)