



cutting through complexity

Historic Scotland

Annual audit report to Historic Scotland
and the Auditor General for Scotland

Audit: year ended 31 March 2014

8 August 2014

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of Historic Scotland and is made available to Audit Scotland and the Auditor General for Scotland (together "the Beneficiaries"). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the Code"). This specifies a number of objectives for the audit.

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance*, this report also summarises our work in relation to the financial statements for the year ended 31 March 2014.

We wish to record our appreciation of the continued co-operation and assistance extended to us by Historic Scotland staff during the course of our work.

Area	Summary observations	Analysis
Service overview		
Business issues	<p>All key performance indicators agreed with the Scottish Ministers for 2013-14, the second year of the current corporate plan, were met or exceeded.</p> <p>Following consultation, a Bill for the establishment of Historic Environment Scotland was introduced to the Scottish Parliament in March 2014. In anticipation of the completion of the Parliamentary process and Historic Environment Scotland being established in 2015-16, Historic Scotland senior management have continued to progress arrangements for the establishment of the new organisation in conjunction with senior management of the Royal Commission on the Ancient and Historical Monuments of Scotland. A 'gateway' review in February 2014 assessed that successful delivery of the project appears probable but with constant attention required to ensure remaining risks do not materialise into major issues threatening delivery.</p>	Pages 6 - 7
Financial position	<p>The outturn for the year ended 31 March 2014 is an under spend against both the operational budget and capital charges totalling £3.1 million. The year saw commercial and tourism income £1.6 million higher than originally forecast. The operational under spend arises due to delays in two planned major capital projects.</p> <p>Management has set a balanced budget for 2014-15 which incorporates the revised Scottish Government grant funding notified in the latest Autumn spending review. The budget assumes commercial and tourism income of slightly above the actual level secured in 2013-14. To mitigate against the risks associated with this income, £700,000 of expenditure will not be committed until there is greater clarity over the anticipated financial outturn.</p>	Pages 8 - 9
Financial reporting and accounting		
Audit conclusions	We have issued unqualified audit opinions on the financial statements for 2013-14, following their approval by the accountable officer.	Page 11
Significant risks and audit focus areas	<p>We have considered inherent significant risks that the ISAs would require us to raise covering risks in relation to revenue recognition and management override of controls and have satisfactorily concluded our work in these areas.</p> <p>Our audit plan for 2013-14 also identified the operation of the framework document within Historic Scotland and preparations for the establishment of Historic Environment Scotland as areas of audit focus. We have raised a further recommendation on the operation of the framework document.</p>	Pages 11, 6 – 7 and 17

Area	Summary observations	Analysis
Financial reporting and accounting (continued)		
Year-end process	Draft financial statements, strategic, directors' and remuneration reports and governance statement were received by the agreed date and were well supported by high quality working papers.	Page 13
Control observations	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are in the main designed appropriately and operating effectively.	Page 13
Governance and narrative reporting		
Governance framework	<p>During the year there were a number of changes in the governance structure of Historic Scotland in anticipation of the establishment of Historic Environment Scotland. This included the mutual secondment of the chief executives of Historic Scotland and the Royal Commission on the Ancient and Historical Monuments of Scotland and the introduction of a joint senior management team. This arrangement allows for close monitoring of progress towards the establishment of the new organisation. We are satisfied that this revised arrangement is appropriate in providing effective leadership and oversight.</p> <p>Following our review, a number of additional disclosures were added to the Historic Scotland remuneration, strategic and directors' reports to reflect the joint senior management team arrangements.</p>	Page 15
Performance management		
Performance management	As part of its targeted approach to following-up a number of performance audit reports each year, Audit Scotland has identified the <i>Managing ICT contracts</i> for targeted follow-up by local auditors in 2013-14. Our work will focus on the ATOS managed services contract. We will submit a report to Audit Scotland concluding on this work by 30 November 2014.	Page 19

Purpose of this report

The Auditor General for Scotland (“the Auditor General”) has appointed KPMG LLP as auditor of Historic Scotland under the Public Finance and Accountability (Scotland) Act 2000 (“the Act”). The period of appointment is 2011-12 to 2015-16, inclusive.

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at Historic Scotland and the Auditor General for Scotland. The scope and nature of our audit were set out in our audit strategy document which was presented to the audit and risk committee at the outset of our audit for 2013-14.

Responsibilities

Audit Scotland’s *Code of Audit Practice* (“the Code”) sets out Historic Scotland’s accountable officer’s responsibilities in respect:

- preparation of financial statements;
- systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- financial position; and
- Best Value.

This report reflects our overall responsibility to carry out an audit in accordance our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code.

The Code sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements, but also consideration of areas such as financial performance and corporate governance.

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) (‘ISA’) 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

This annual audit report to members and our presentation to the audit and risk committee, together with previous reports to that committee throughout the year, discharges the requirements of ISA 260.

Service overview

Our perspective on key business issues and
the financial position of the Agency

Against a back drop of prospective organisational change, there is a continued focus on operational efficiency.

Commercial and tourism income performed strongly in year and exceeded original budget by £1.6 million.

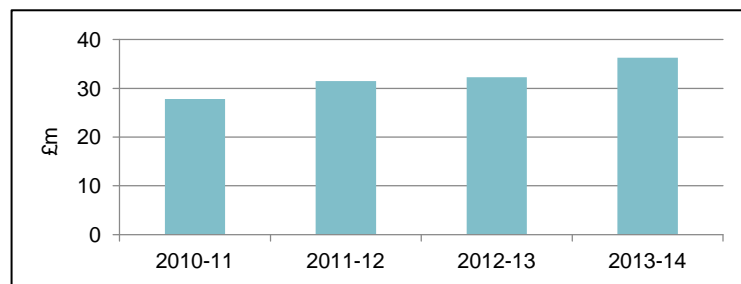
By the year end the Bannockburn project was approaching completion and was forecast to be completed within forecast and timeframe.

Management are continuing to prepare for the establishment of Historic Environment Scotland through a merger with the Royal Commission on the Ancient and Historical Monuments of Scotland.

Operational performance

There has been a continued focus on efficiency, with strong operational performance against the key performance targets agreed with the Scottish Ministers. This is against a back drop of organisational change, with the Bill for creation of the new body, Historic Environment Scotland, being presented to the Scottish Parliament in March 2014. Historic Scotland is responsible for delivering some of the capital projects and cultural planning associated with the Homecoming programme, as part of its operations and functional service delivery. Development on a number of significant projects, including Bannockburn in partnership with the National Trust for Scotland, continued in 2013-14. At the time of audit finalisation, the Bannockburn project was approaching completion and it was anticipated that the project would be both within budget and delivered by the agreed deadline.

A development in strategy in 2013-14 saw an increased focus on growth in commercial and tourism income in order to support planned decreases in government funding. Commercial and tourism income performed strongly in the year and exceeded original forecasts by £1.6 million. The graph below charts the growth in commercial and tourism income over the previous four years. Growth of 31% has been achieved over this period.



Source: Financial statements

For the first time, management have set a budget that recognises more than half of Historic Scotland's cash income will be from non-government sources in 2014-15. However, the recent rate of growth in commercial and tourism income may be difficult to sustain long term as Historic Scotland will need to continue to find new areas of the market to grow. In the short term, there are several significant tourism related events (Ryder Cup and the Commonwealth Games) in 2014-15 that have the potential to boost tourism in Scotland and hence increase visitor numbers to Historic Scotland sites.

As part of Historic Scotland's focus on efficiency and cost reduction, applications for voluntary redundancies were invited in 2013-14. Nine redundancy packages were awarded at a total cost of £300,000; these employees formally left Historic Scotland on 31 March 2014. Our audit work confirmed that these amounts were appropriately authorised, calculated correctly and appropriately disclosed within the financial statements.

Establishment of Historic Environment Scotland

The business case for the merger of Historic Scotland and the Royal Commission on the Ancient and Historical Monuments of Scotland through the establishment of Historic Environment Scotland was approved by the Cabinet and issued for consultation on 8 May 2013. The Bill for the creation of the new body Historic Environment Scotland was presented to the Scottish Parliament in March 2014. As part of the Parliamentary process, various committees request evidence in their role of scrutinising and refining the Bill. Historic Scotland had been engaged in this process and has submitted written and oral evidence.

A ‘gateway’ review of the Historic Environment Scotland transition programme occurred in February 2014 and resulted in an overall confidence assessment of ‘amber-green’. Four critical recommendations were made which are being addressed by management.

We are broadly satisfied with the arrangements that management have in place for both progressing with the programme and for monitoring progress.

Subject to the required legislation being approved, the new body should commence operation during 2015, but the exact timing has still to be determined and consideration is being given to implementation on a phased basis. We will continue to monitor management’s intention in this regard and assess the accounting and audit implications that this decision could have and engage in discussions with management where appropriate; this is expected to an area of focus is our audit of the 2014-15 financial statements.

A ‘gateway’ review was conducted by the Scottish Government in February 2014. This was the first gateway review and was a strategic assessment of the programme that set the programme in the wider policy or corporate context. The review investigated the direction and planned outcomes of the programme, together with the progress of its constituent projects. Such a review can be particularly valuable in that it helps to confirm that the way forward is achievable, before plans have been finalised.

The conclusion of the review was that the overall delivery confidence assessments was ‘amber- green’. This rating is defined as “successful delivery appears probable however constant attention will be needed to ensure risks do not materialise into major issues threatening delivery”. The review also noted that there was evidence that the programme is “learning lessons to progress in a positive and informed way”. The review team commended the early adoption of an iterative lessons learned process.

The review team made a total of five recommendations; four of which are critical. Specifically:

- review the business case on an on-going basis to reflect the current state of the programme;
- articulate benefits with clearly defined measures, performance indicators and delivery dates;

- review the published mitigating actions for risks and where possible consideration should be given to contingency plans in addition to these mitigating actions;
- define the “must do” deliverables for 1 April 2015 and those deliverables that can be delivered subsequently; and
- review periodically the role of the change manager and the responsibility to co-ordinate and manage the organisational changes (non-critical).

Management promptly formulated an action plan to address these recommendations and progress has commenced against this action plan. We have reviewed the content of the report and, whilst we have not identified any specific audit risks, we will continue to monitor management’s actions in relation to the merger as part of our wider risk assessment procedures.

Arrangements for the establishment of Historic Environment Scotland is a evolving process, with many aspects still to be finalised. The joint senior management team receives monthly progress updates on the programme and summary reports are also presented to the Agency’s audit and risk committee. These are considered alongside the separate risk register established for the programme. As at 18 March 2014 the programme’s risk status was assessed as “amber/green” and was unchanged from the previous status report. An organisational development manager has been appointed to support the development of an operational framework for the new organisation.

At the current time, we are broadly satisfied with the arrangements that management have in place for both progressing with the programme and for monitoring progress. We will continue to monitor the situation through our risk assessment procedures, minute reviews and regular discussions with senior managers.

The outturn as at 31 March 2014 was an under spend of £3.1 million.

Following discussions with the Scottish Government, grants of £750,000 planned for 2014-15 were re-profiled into 2013-14.

A grant of £500,000 was made by Historic Scotland to the Historic Scotland Foundation; this amount will be awarded back to Historic Scotland in future years.

Financial performance

Expenditure for the year to 31 March 2014 is £3.1 million under budget. Performance against the budget is summarised below.

	Budget £000	Actual £000	Variance £000
Income			
Commercial income	36,195	36,331	136
Less: Direct cost of sales	(4,400)	(4,499)	(99)
Scottish Government funding	45,304	45,304	-
Other receipts	1,696	1,862	166
Total	78,795	78,998	203
Expenditure			
Policy	373	361	12
Heritage management	3,808	3,802	6
Conservation	26,551	26,461	90
Commercial and tourism	16,819	16,909	(90)
Corporate services	28,482	26,247	2,235
Capital charges (depreciation and impairment)	3,312	2,106	1,206
Total	79,345	75,886	3,459
Outturn	(550)	3,112	

Source: Year end management accounts

The under spend consists of two main elements: cash variance of £1.9 million and non-cash of £1.2 million, the latter relates to lower than anticipated capital charges.

The cash variance mainly reflects delayed capital expenditure of £1.7 million on two projects, the majority of which relates to the rockfall mitigation project at Edinburgh Castle from delays in obtaining necessary planning permissions. Management were unsuccessful in a request to the Scottish Ministers to roll forward this under spend to 2014-15.

In 2013-14 there was strong growth in commercial income which finished at a full year level of £36.3 million representing an increase of 12.60% over 2012-13 outturn and a £1.6 million increase on the original forecast. In developing the original budget for 2013-14 an amount of £1.4 million was not initially allocated to directorate budgets due to the difficulties in achieving the income target in the previous year. Following strong performance in the first four months of 2013-14 (enabling revised full year forecasts to be prepared), a decision was made in August 2014 to release this amount.

Following briefing to the Scottish Government, approval was secured for the re-profiling of grants from 2014-15 to 2013-14 to the value of £750,000 as part of year end flexibility arrangements. Furthermore, the Scottish Government agreed an amount of £500,000 be awarded to the Historic Scotland Foundation.

A balanced budget for 2014-15 has been set which assumes £36.7 million of income generated from commercial and tourism activities.

There are risks around the achievement of the anticipated staff costs budget.

£700,000 of expenditure will not be committed until later in the year when there is greater certainty over the likely financial outturn.

Financial plans 2014-15

The 2014-15 budget is summarised below:

	£m
Scottish Government grant /core funding	37.1
Commercial income	36.7
Other income	1.0
Capital	0.4
Total	75.2
Staff costs	31.6
Investments	14.5
Amount allocated for programme budgets	19.0
Amount allocated for non-capital charges	0.4
Scottish Government capital charges non-cash	3.3
Cost of retail goods for resale	4.4
Corporate projects and contingency	2.0
Total	75.2

Source: *Management accounts*

Scottish Government funding is forecast at the amount notified in the Autumn spending review, adjusted for costs associated with the transfer of the policy unit back to the Scottish Government. In effect this is a net reduction of £2.2 million in allocation from 2013-14 compared with the 2011 spending review which anticipated a £4 million net reduction for 2014-15.

The budget for 2014-15 assumes commercial and tourism income of £36.7 million. This is slightly above the level achieved in 2013-14. Management's decision to budget at this level appears reasonable and experience based. However, as the income can be difficult to predict and is affected by various factors outside of Historic Scotland's control, robust monitoring will be required throughout the year to assess the appropriateness of the budget assumptions with mitigating actions taken where required. Prudently, to mitigate against an element of this risk, management have required directorates to avoid committing £700,000 of expenditure until later in the financial year where there will be greater certainty over the total income levels.

Staff structures have been agreed between Historic Scotland's human resources team and individual directorates. Management assumes that the savings can be achieved by focusing on various initiatives and will continue to pay close attention to the management of staff costs to remain within the overall budgeted level. This will be supported through a recruitment time lag, savings in overtime and a reduction in centrally managed pay. These measures do however carry a high element of risk and include an assumed £1.7 million of savings from a pay agreement previously implemented. Savings from voluntary early severance have already been incorporated.

Expenditure on programme budgets have been maintained at the 2013-14 level of £19 million. Directorates, with two exceptions, have been able to absorb at least 2% reductions from the 2013-14 budget level.

Financial statements and accounting

Our perspective on the preparation of the
financial statements and key accounting
judgements made by management

We have issued an unqualified audit opinion on the financial statements and the regularity of transactions reflected in those financial statements.

International Standards on Auditing require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk and that management override of controls is a significant risk. We have satisfactorily carried out audit work to address these risks.

Audit conclusions

Following approval of the financial statements by Historic Scotland's accountable officer we have issued an unqualified opinion on the truth and fairness of the state of Historic Scotland's affairs as at 31 March 2014, and of its net operating cost for the year then ended. We also have issued an unqualified opinion on the regularity of transactions within the year. There are no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks;
- liaised with internal audit and reviewed their reports to ensure all key risk areas having a potential financial statements impact have been considered;
- reviewed assumptions and judgements made by management and considered these for appropriateness;
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to prevention and detection of fraud with the potential to impact on the financial statements; and
- attended the audit and risk committee to communicate our findings to those charged with governance, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

Significant risks

Revenue recognition

For commercial and tourism revenue we recognised that the fraud risk from revenue recognition was a significant risk and planned and conducted appropriate procedures. To address this risk, we have performed controls testing over income authorisation and reconciliations including 'higher level' controls, predictive substantive analytical reviews and cut off testing on the commercial and tourism revenue. As grant-in-aid is agreed in advance of the year, with adjustments requiring Scottish Government approval, we did not regard the risk of fraud in its recognition as significant.

We have obtained sufficient evidence that the risk of fraud in revenue recognition is within our acceptable materiality levels and did not identify any errors that required adjustment in the financial statements.

Management override of controls

To address this risk, we have performed testing of journal entries during the year and at the year end, undertaken a review of unusual transactions in the year, made enquiries with employees outside the finance department, incorporated audit tests of an unpredictable nature and undertaken testing of controls, including 'higher level' controls and reviewed management's accounting estimates for bias.

Our work did not identify any matters that required adjustment in the financial statements or which require to be brought to your attention.

There have been no substantive changes to the financial reporting framework as set out in HM Treasury's *Financial Reporting Manual* ("FReM").

There have been no changes to accounting policies in 2013-14. All accounting policies have been applied consistently.

The financial statements have been prepared on a going concern basis; we are satisfied that this is appropriate.

<p>Financial reporting framework</p>	<ul style="list-style-type: none"> ■ Historic Scotland prepared the financial statements in accordance with HM Treasury's Financial Reporting Manual 2013-14 ("FReM"). ■ Changes to the FReM in 2013-14 require Historic Scotland to prepare a strategic report in line with section 414C of the Companies Act 2006 as interpreted by the FReM. The strategic report requirements include disclosures previously required within the directors' report and new disclosures (if not previously included) on social, community and human rights issues, a description of the body's strategy and business model and a gender break down of directors, senior managers and employees. Appropriate disclosure has been included within the strategic report. ■ During the year there have been no substantive changes in financial reporting requirements, and consequently there are no changes to the Historic Scotland's accounting policies. We are satisfied that the accounting policies adopted remain appropriate.
<p>Impact of revised accounting standards</p>	<ul style="list-style-type: none"> ■ There are no newly effective accounting standards are considered to have a material impact on the Historic Scotland's financial statements in the coming year. Appropriate disclosure to this effect is included within the accounting policies note to the financial statements.
<p>Going concern</p>	<ul style="list-style-type: none"> ■ The financial statements have been prepared under the assumption that the organisation is a going concern. We have reviewed, and challenged, management's decision to prepare the financial statements under the going concern assumption in the light of legislative arrangements for the establishment of Historic Environment Scotland. ■ While the exact timing of the establishment of the new organisation is presently undetermined, it is not anticipated that this will be before 1 April 2015 due to the timeframes involved in the Parliamentary process. It is currently anticipated that Historic Environment Scotland will provide the same services as Historic Scotland using the same assets as present, but these functions will not transfer to Historic Environment Scotland until at least October 2015 (i.e. not within 12 months of the 2013-14 financial statements). Scottish Government funding for 2014-15 has been approved and indicative funding for 2015-16 has been notified to Historic Scotland; this has been used to set a balanced budget for 2014-15. Accordingly, we are satisfied that it is appropriate for the accountable officer to have prepared the financial statements on a going concern basis.

The financial statements were made available on a timely basis and were accompanied by high quality working papers.

Our testing of the design and operation of financial controls over significant risk points confirmed these were operating effectively.

Financial statements preparation	<ul style="list-style-type: none"> Throughout the course of the year we had regular communication with Historic Scotland's finance team to ensure that disclosure within the financial statements was consistent with the requirements of the FReM. We provided feedback to management on the content of the financial statements, annual report and remuneration report, and we are pleased to report that these were subsequently prepared appropriately. In advance of our audit fieldwork, we issued a 'prepared by client' request setting out a list of required analyses and supporting documentation. The standard of documentation was good and there was evidence of accountability and ownership of working papers across the finance department. High quality working papers and substantially complete draft financial statements were provided at the start of the audit fieldwork in May 2014. This included the remuneration report. Revised strategic and directors' reports were provided in the second week of our audit field work.
Internal controls	<ul style="list-style-type: none"> Historic Scotland management are responsible for designing and implementing appropriate internal control systems. Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively. In our interim audit report, we raised one 'low' graded recommendation over the authorisation of grants which was accepted by managements for implementation by 30 April 2014.
External inspection	<ul style="list-style-type: none"> HM Revenue and Customs ("HMRC") undertook an inspection of Historic Scotland's records in 2013-14, the result of which was a requirement to settle an additional £86,000 in a combination of underpaid payroll taxes and penalties. HMRC also made a number of recommendations relating to the future engagement status of a number of contractors currently treated as self employed. Part of the settlement is being met by the Scottish Government as a result of problems within a previous framework agreement reducing to £56,000 the net cost to Historic Scotland.
Other matters	<ul style="list-style-type: none"> Mandatory communications required by International Standards on Auditing are given in Appendix one. There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content.

Governance and narrative reporting

Our overall perspective on your narrative reporting, including the remuneration report and annual governance statement

Update on controls findings from our audit

We updated our understanding of the governance framework and did not identify any issues which require to be brought to your attention.

Various changes to the governance structure were implemented in 2013-14; associated with the establishment of Historic Environment Scotland.

Annual governance statement and governance arrangements

The governance statement for 2013-14 outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements and analyses the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer.

The statement, which is made by the accountable officer, considers the effectiveness of the system of internal control based on information provided by the audit and risk committee and internal audit. The statement identifies that there have been no significant risk-related matters and no significant lapses of data security.

During 2013-14 changes to the governance structure were implemented as part of the preparation for the establishment of Historic Environment Scotland:

- the advisory committee, which is responsible for advising the chief executive on strategic and operational issues, ceased meeting at regular intervals and now meets on an *ad hoc* basis;
- the senior management team ceased meeting on a regular basis and now meets when it is determined that there is a need. The functions previously carried out by the senior management team are now carried out on a joint basis between Historic Scotland and the Royal Commission on the Ancient and Historical Monuments of Scotland; and
- there was a mutual secondment of chief executives between Historic Scotland and the Royal Commission on the Ancient and Historical Monuments of Scotland which has resulted in both chief executives working for Historic Scotland at points in 2013-14. The current arrangement is that there is a joint chief executive role at Historic Scotland which will continue until October 2015.

As part of our wider risk assessment procedures, we have considered the effectiveness of the new governance arrangements and we have not identified any concerns at this time. We are satisfied that the governance structure in place is appropriate and providing effective leadership and oversight of Historic Scotland.

We have updated our understanding of the governance framework and documented this through our overall assessment of Historic Scotland's risk and control environment. We have reviewed the governance statement and have confirmed that it is in line with guidance, reflects our understanding of Historic Scotland and appropriately reflects the changes in the governance structure identified in 2013-14. We therefore consider the governance framework and annual governance statement to be appropriate for Historic Scotland.

<p>Annual report, including the strategic and directors' reports</p>	<p>The financial statements form part of the annual report of Historic Scotland for the year ended 31 March 2014. Following amendments to the Companies Act (adopted through the FReM), Historic Scotland has been required to include both a strategic and a directors' report as part of its annual report. The strategic report must contain a minimum level of information, through prescribed headings, the information largely presented within the directors' report in prior years. We have reviewed the contents of the strategic and directors' report against the revised disclosure requirements. We provided management with a number of suggestions relating to areas where these reports could be enhanced and/or where additional information disclosures should be made. Management has responded positively to our suggestions and have made the appropriate updates to the final reports.</p> <p>We are required to consider the strategic and directors' reports, and provide our opinion on the consistency of it with the financial statements. We are satisfied that the information contained within the strategic and directors' reports is consistent with the financial statements.</p>
<p>Remuneration report</p>	<p>The remuneration report was provided in advance of the commencement of the audit, and supported by good quality information to support the disclosures provided, albeit that pensions information was not available until later. The 2013-14 FReM included an additional requirement for disclosure of total directors' remunerations as a single figure; this has been correctly included within the financial statements.</p> <p>The FReM requires that directors are included within the remuneration report. Although not remunerated by Historic Scotland, members of the joint senior management team from the Royal Commission on the Ancient and Historical Monuments of Scotland can be classified as directors of Historic Scotland as they are able to influence and direct the activities of Historic Scotland. Additional disclosures have been included in the remuneration report in relation to the joint senior management team members from the Royal Commission.</p>
<p>Internal audit</p>	<p>As set out in our audit plan and strategy, we evaluated the work of internal audit and concluded that we can apply their work to inform our procedures, where relevant. The content of the internal audit plan is, in our view, comprehensive and is increasingly focussed around aspects of the arrangements over the establishment of Historic Environment Scotland. We reviewed a number of reports, including those in respect of human resources, visitor attraction system, validation of key performance targets and financial controls and income generation. Overall, internal audit provided 'substantial assurance' in respect of the Agency's risk management, control and governance arrangements.</p> <p>There were no significant issues identified in internal audits reviews that have impacted on our planned audit approach.</p>

<p>Historic Scotland Foundation</p>	<p>As part of its end of year outturn discussions with the Scottish Ministers, Historic Scotland sought and obtained permission to make a grant of £500,000 to the Historic Scotland Foundation. This Foundation was established in 2001 as an independent charity with the primary purpose of providing funds to Historic Scotland or otherwise to advance the work of Historic Scotland. Prior to 2013-14, funds have been raised from third parties which have then been applied to Historic Scotland projects. This has included, for example, support for the recent refurbishment work at Stirling Castle.</p> <p>In the light of Historic Scotland making a payment itself to the Foundation which in turn is likely to be applied to support Historic Scotland's work, we have reviewed the relationship between Historic Scotland and the Foundation. While we are satisfied that Historic Scotland does not have control over the Foundation and hence group financial statements are not required, we draw your attention to this arrangement and the movement of financial resources between accounting periods secured by its use.</p>
<p>Prevention and detection of fraud</p> <p>Arrangements for maintaining standards of conduct and the prevention and detection of corruption</p>	<p>Procedures related to fraud are designed and implemented effectively. This includes a whistle blowing policy that can be found on the Historic Scotland intranet. The audit and compliance team complete random checks at sites throughout the year which enhance the control environment, particularly with respect to stock and cash balances. No significant fraud or irregularity has been identified during the year.</p> <p>Our 2012-13 audit indicated limited awareness of an IT contract by senior management, indicating weaknesses in the financial delegations in the framework document. As set out in our audit strategy overview for 2013-14, we considered the application of delegated authorities.</p> <p>The chief executive has delegated various financial responsibilities to directors and, in turn, those directors will sub-delegate to heads of business. To ensure propriety, these delegations are formally acknowledged by recipients and returned centrally. Some parts of the business initially appeared reluctant to confirm delegation formally and there were delays in this process in 2013-14 which resulted in some delegations only being signed towards the end of the financial year. It is important that management ensure that the process is undertaken in a more timely manner in 2014-15.</p> <p style="text-align: right;">Recommendation 1</p>
<p>National Fraud Initiative ("NFI")</p>	<p>The National Fraud Initiative ("NFI") is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches. Our review of Historic Scotland's participation arrangements resulted in a recommendation agreed with management for a review of non-recommended data matches. Overall, we were satisfied with the progress made in the investigation of matches and the level of engagement in the NFI exercise.</p>

Performance management

Our perspective on the performance
management arrangements, including follow
up work on Audit Scotland reports

Historic Scotland's Best Value and performance management arrangements remain largely unchanged and we did not identify any issues which require to be brought to your attention.

<p>Best Value</p>	<p>In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure there are arrangements designed to secure Best Value. Audit Scotland is committed to extending the Best Value audit regime across the whole public sector. Using the Scottish Executive's nine Best Value principles as a basis for audit activity, Audit Scotland previously selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working).</p> <p>Management have not utilised the Best Value toolkits, but a number of aspects of arrangements to deliver Best Value are effectively embedded into policies and practices. For example, management participate in the procurement capability assessment exercise and have previously improved their rating under this assessment. The procurement policy has a number of stated objectives and performance indicators associated with delivering Best Value. There may be further opportunities for Historic Scotland to improve its practices by adopting other principles from Best Value toolkits and so we would encourage use of the toolkits to be made where appropriate, for example in respect of community engagement, partnership working and community engagement or customer focus and responsiveness.</p> <p>In 2013-14, Historic Scotland had a 3% efficiency saving target, equating to £1.4 million, compared with 2012-13. This target was achieved in the year. In respect of 2014-15, a 3% efficiency target has again been set and management intend to achieve efficiency savings in 2014-15 through payroll reductions as outlined on page nine.</p>
<p>Performance management</p>	<p>Historic Scotland's annual report will include a summary of performance against a number of Key Performance Targets ("KPT's") which, in our opinion, represented challenging targets that were well aligned with strategic objectives of Historic Scotland. Management are not anticipating being able to finalise the summary of performance by the date of our audit report and consequently we will not be able to review this summary for consistency with the financial statements; this summary will be included in a separate section in the annual report to clearly demonstrate that its contents are not covered by the audit report.</p> <p>As part of our wider risk assessment procedures, we have considered performance against KPTs, as reported to the senior management team (and the joint senior management team) through the year, and have not identified any audit risks. Internal audit conducted a review of KPT arrangements covering 'data collection and reporting' and 'communication and use of data' and concluded that Historic Scotland has in place a well-structured and embedded KPT framework.</p>
<p>Local response to national studies</p>	<p>Audit Scotland periodically undertakes national studies on topics relevant to the performance of central government bodies. To ensure that added value is secured through the role of Audit Scotland and its appointed auditors, auditors will continue to ensure that audited bodies respond appropriately to reports from Audit Scotland's programme of national performance audits.</p> <p>As part of its targeted approach to following-up a number of performance audit reports each year, Audit Scotland has identified <i>Managing ICT contracts</i> for targeted follow-up by local auditors in 2013-14. The aim of the follow-up work is to establish to what extent central government bodies have applied the lessons learned highlighted by the report to their ICT contracts and arrangements. Our work will focus on the ATOS managed services contract. We will submit a report to Audit Scotland concluding on this work by 30 November 2014.</p>

Appendices

Mandatory communications regarding audit adjustments, auditor independence and representation letter content are given here.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	<p>There were no audit adjustments required to the draft financial statements which impacted on the net assets or the net expenditure for the year.</p> <p>A small number of numerical and presentational adjustments were required to some of the financial statements notes. The most significant of which were:</p> <ul style="list-style-type: none"> ■ disclosure that the £500,000 granted to Historic Scotland Foundation in 2013-14 is part of the overall grants total; ■ additional disclosure in the related party transaction note for members of the joint senior management team from the Royal Commission on the Ancient and Historical Monuments of Scotland; and ■ inclusion of full prior year comparatives in the segmental reporting note. 	-
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	<p>We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you.</p> <p>There are no unadjusted audit differences.</p>	-
Confirmation of Independence Letter issued by KPMG to the Audit Committee	<p>We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Director and audit staff.</p>	Appendix three
Schedule of Fees Fees charged by KPMG for audit and non-audit services	<p>Audit fees were in accordance with the There were no non-audit services in 2013-14.</p>	-
Draft management representation letter Proposed draft of letter to be issued by Historic Scotland to KPMG prior to audit sign-off	<p>There are no significant changes to the standard representations required for our audit from that for last year.</p>	-

Auditing Standards require us to consider and confirm formally our independence and related matters in our dealings with the Agency.

We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.

Professional ethical standards require us to provide to you at the conclusion of an audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by Historic Scotland for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards.

As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Chief Executive.

Confirmation of audit independence

We confirm that as of 27 June 2014, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the audit and risk committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

The action plan summarises specific recommendations arising from our work, together with related risks and management’s responses.

Priority rating for recommendations

Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.

Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.

Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)

Recommendation(s)

Agreed management actions

1 Financial responsibility delegation

The chief executive has delegated various financial responsibilities to directors and, in turn, these directors will sub-delegate to heads of business areas. There were delays in the process in 2013-14 which resulted in the process being completed late in the financial year.

There is a risk that the process will be delayed in 2014-15 potentially resulting in employees entering Historic Scotland into transactions having not accepted and understood their responsibilities.

Management should continue to monitor this process and ensure that it is completed in an appropriate timeframe.

Grade two

Lessons have been learned from the 2013-14 process. Accountable Officer to Director letters were issued at an earlier stage than previously. This will enable sub-delegation letters to be issued and returned earlier also. An ‘all staff’ notice setting out the background to the scheme of delegations will assist in clarifying individual responsibilities.

Responsible officer:

Strategic Management Accountant / Head of Management Accounts

Implementation date:

31 July 2014



cutting through complexity

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