



## **Historic Environment Scotland**

Report to the Audit Risk and Assurance Committee (ARAC), the Board and the Auditor General for Scotland on the 2017/18 audit

Issued on 16 July for the meetings on 25 July and 20 August 2018

# Contents

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## 01 Our final report

Introduction	3
Our audit explained	8
<b>Financial statements audit</b>	9
Significant risks	10
Other significant findings	15
Our audit report	18
Your annual report	19
<b>Audit dimensions</b>	20
Overview	21
Financial sustainability	22
Financial management	24
Governance and transparency	26
Value for money	28
Specific risks	29

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## 02 Appendices

Purpose of our report and responsibility statement	32
Audit adjustments	33
Action plan	34
Fraud responsibilities and representations	41
Independence and fees	42
Events and publications	43

# Introduction

## The key messages in this report

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

I have pleasure in presenting our final report to the Audit, Risk and Assurance Committee (ARAC) of Historic Environment Scotland (HES) for the 2017/18 audit. The scope of our audit was set out within our planning report presented to the Committee in January 2018.

This report summarises our findings and conclusions in relation to:

- The audit of the **financial statements**; and
- Consideration of the **four audit dimensions** that frame the wider scope of public sector audit requirements as illustrated in the following diagram. This includes our consideration of the Accountable Officers' duty to secure best value.



# Introduction (continued)

## The key messages in this report – financial statements audit

I would like to draw your attention to the key messages of this paper in relation to the audit of the financial statements:

### Conclusions from our testing

- The significant risks, as identified in our audit plan, related to:
  - Completeness of commercial income;
  - Investment grants;
  - management override of controls; and
  - Restricted funds.
- A summary of our work on the significant risks is provided in the dashboard on page 10.
- We have identified one audit adjustment from our procedures to date in relation to the revaluation which has been corrected by management. This is also detailed in the appendices.
- The Trustees report and annual governance statement comply with the statutory guidance and proper practice and are consistent with the financial statements and our knowledge of HES.
- The Charities SORP does not require a separate remuneration and staff report, however, HES has chosen to publish one in accordance with the requirements of the Government Financial Reporting Manual (FRoM) to aid transparency. The auditable parts of the remuneration and staff report have been prepared in accordance with the relevant regulation.
- Based on our audit work to date and subject to completion of the outstanding items, we expect to issue an unmodified audit opinion.
- Our audit work is also substantially complete for the two subsidiaries, Historic Environment Scotland Enterprises Limited (HESe) and SCRAN Limited, where we envisage issuing an unmodified audit opinion for HESe. As SCRAN Limited has ceased trading and is therefore no longer a going concern, our audit opinion includes an emphasis of matter to confirm that, in forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosure made in the notes to the financial statements, which explains that the financial statements have been prepared on a basis other than that of a going concern.

# Introduction (continued)

## The key messages in this report – financial statements audit

I would like to draw your attention to the key messages of this paper in relation to the audit of the financial statements:

### Insights

- We have utilised Spotlight, Deloitte's patented analytics tool, to perform analytics on the journal entries posted in the year to profile the journal population which has helped us identify journals of audit interest, such as journals posted on non-business days or journals with key words. No issues were noted from this testing.
- We have raised insights relating to the valuation of property assets, IT controls, stock controls, and accounting for restricted/unrestricted funds. These have been identified throughout the course of the audit and are detailed on pages 34 to 36.
- We have followed up the issues raised in our 2016/17 report, in particular the control weakness identified in the treatment of grants and are satisfied that the agreed action has been implemented. Further details of conclusions drawn on each prior year recommendation is detailed on pages 37-41.

### Status of the audit

- The audit is substantially complete subject to the completion of the following principal matters:
  - final review of updated financial statements for HES, HESe and SCRAN;
  - finalisation of our internal quality control procedures;
  - receipt of signed management representation letter; and
  - our review of events since 31 March 2018.

# Introduction (continued)

## The key messages in this report – audit dimensions

The following two pages set out the key messages of this paper in relation to the four audit dimensions:

### Financial sustainability

HES continues to face a challenging financial position. While it met all of its financial targets in 2017/18 and the budget is anticipating a break-even position for 2018/19, the draft Financial Strategy identifies potential funding gaps in 2019/20 and 2020/21. If no action is taken, the potential funding gaps are anticipated to widen to 2030. The strategy clearly sets out possible avenues for intervention to bridge the funding gap into future years. We recommend that this is finalised as soon as possible, with a clear plan of actions required to bridge the potential funding gap. This should be clearly linked to any transformation plan. It is important that HES consider the supporting infrastructure required to deliver the changes required.

HES recorded a **net surplus outturn of £3.278m** for 2017/18. This comprised a small deficit against its cash resource limit of £90k, offset by a surplus against the non-cash limit of £3.368m.

These operational results exclude the financial impact of accounting for grants un in accordance with the Charities SORP. After adjustments, HES reported a small surplus (£1.019m) in its Statement of Financial Activities (SOFA).

A balanced **budget for 2018/19** was approved in February 2018.

Excluding budgeted self-generated income of £57.1m, net expenditure is £41.1m is budgeted to be met from Scottish Government (SG) funding. This is an increase of £4.1m on the actual SG funding in 2017/18. As discussed further on page 23, due to higher self-generated income, the SG funding for 2017/18 was reduced to £37m from the original budget of £45m.

The draft Financial Strategy identifies that if no action is taken, there is a **potential funding gap in 2019/20 (£1.22m) and 2020/21 (£5.50m)**, which widens beyond that to 2030 with an anticipated deficit of **£14.7m in 2030** if no action is taken. The strategy clearly sets out possible avenues for intervention to bridge the funding gap into future years.

### Financial management

The Board has effective financial planning and management arrangements in place. We are satisfied the Board has strong financial monitoring arrangements and is robust enough to sufficiently capture any changes in the achievement of financial targets. We also note a significant improvement from last year in improving the capacity of the finance team.

# Introduction (continued)

## The key messages in this report – audit dimensions (continued)

### Governance and transparency

The Board's governance framework and arrangements, including decision making and scrutiny, are appropriate and support good governance and accountability.

The Board has strong executive leadership. The relationship between board members and officers is good, and there is evidence of effective challenge from committee meetings. The Board is open and transparent in its decision making with all minutes available through the Board's website.

The quality and timeliness of financial performance reporting is good with timely reporting to Senior Management Team (SMT) on a monthly basis and the Board on a quarterly basis.

### Value for Money

There is a clear framework in place to ensure that HES performance is monitored and reported. This is based on five key HES themes of lead, understand, protect, value and perform. It is clear that the Board has continued to make substantial progress in its second year of applying the 2016-2019 Corporate Plan.

As reported in our 2016/17 report, we would like to see increased visibility of resource and financial planning being based on the evidenced based contribution to key HES priorities and national performance outcomes. This would link resource planning to the outcomes achieved with clear supporting KPI's. We understand from management that work in developing this is at an early stage.

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**Pat Kenny**  
Audit Director

# Our audit explained

## Area dimensions

In accordance with the 2016 Code of Audit Practice, we have considered how you are addressing the four audit dimensions:

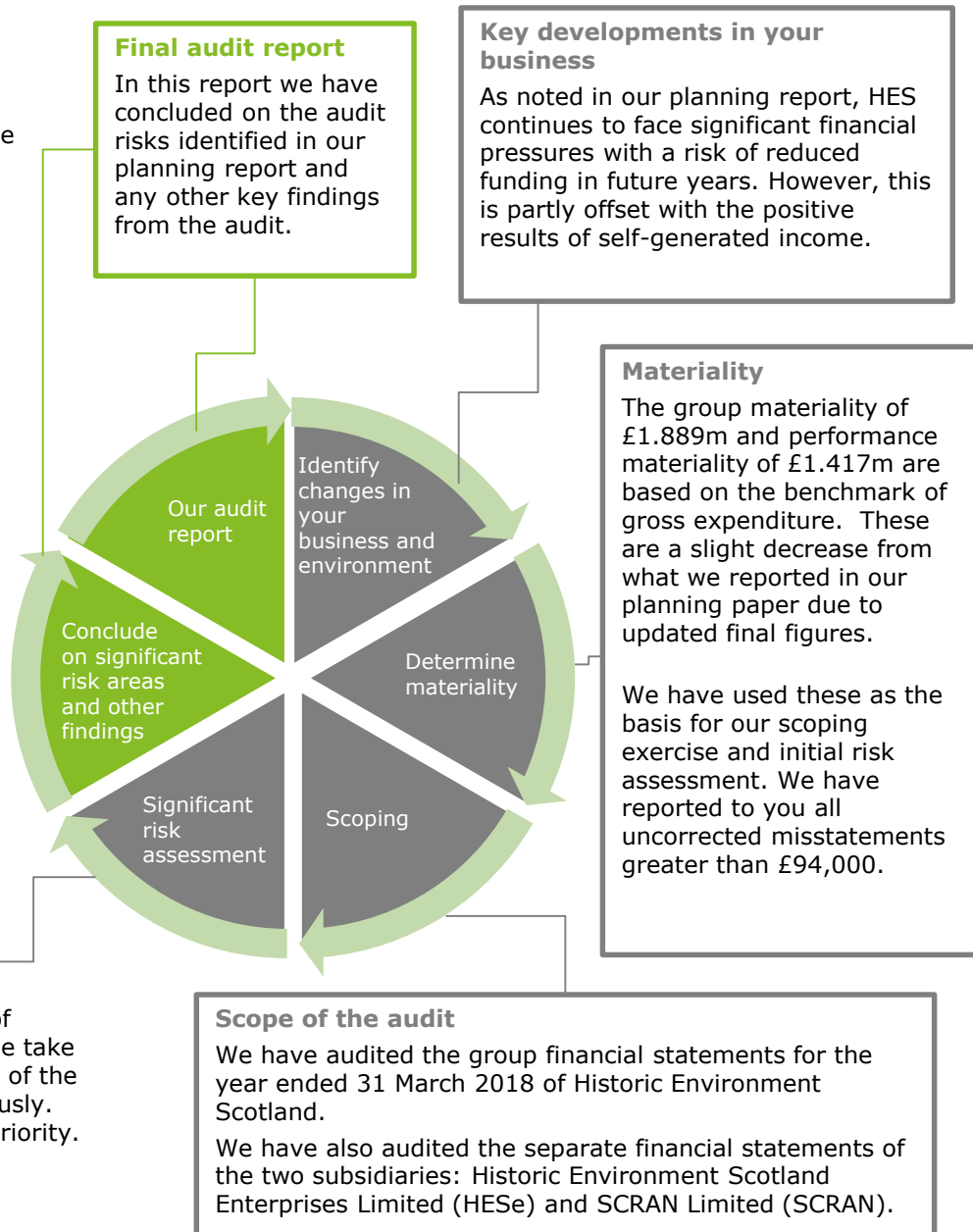
- Financial sustainability
- Financial management
- Governance and transparency
- Value for money

## Significant risks

Our risk assessment process is a continuous cycle throughout the year. Page 10 provides a summary of our risk assessment of your significant risks.

## Quality and Independence

We confirm we are independent of Historic Environment Scotland. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.



## Timeline 2017/18

















# Financial statements audit



# Significant risks Dashboard

Risk	Material	Fraud risk	Planned approach to controls testing	Controls testing conclusion	Consistency of judgements with Deloitte's expectations	Comments	Slide no.
Completeness of commercial income <sup>1</sup>			D+I	Satisfactory		Satisfactory	11
Investment grants			D+I	Satisfactory		Satisfactory	12
Management override of controls <sup>2</sup>			D+I	Satisfactory		Satisfactory	13
Restricted funds			D+I	Satisfactory		Satisfactory	14

- <sup>1</sup> This risk covers both HES and HESE
- <sup>2</sup> This risk covers HES, HESE and SCRAN

Overly prudent, likely to lead to future credit



Overly optimistic, likely to lead to future debit.

**D+I:** Testing of the design and implementation of key controls

# Significant risks (continued)

## Risk 1 – Completeness of commercial income

### Risk identified

ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

The main components of income for HES, are government grant in aid and commercial income. Grant in aid is directed by the Scottish Government and not considered a significant risk as the process for receipt of this income is not complex and can be verified 100%. The significant risk is pinpointed to completeness of commercial income, being income from admissions and retail income (from the trading subsidiary, HESe) from properties in care. As regular reconciliations are performed between the bank accounts and the amounts recognised via the Galaxy till receiving system, the risk is focused on how any reconciling items are investigated and addressed. This was our key area of audit focus.



### Key judgements and our challenge of them

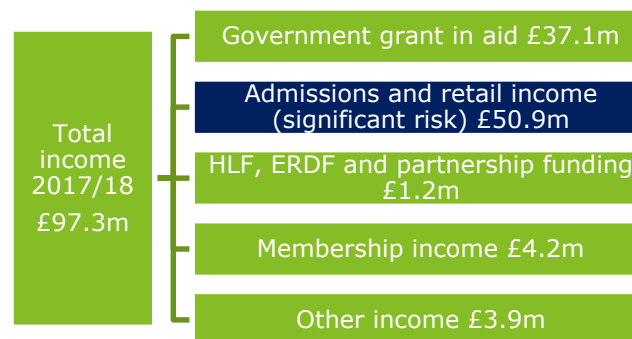
As commercial income comprises low value, high volume cash transactions across multiple locations there is an inherent risk of fraud in respect of these balances.



### Deloitte response

We have performed the following:

- obtained an understanding of the design and implementation of the key controls in place in relation to recording of commercial income;
- performed analytical procedures over commercial income reported for the year, based on visitor numbers and price changes, to confirm accuracy;
- tested the visitor numbers by agreeing a sample back to till receipts to confirm completeness; and
- Performed detailed testing of the year-end reconciling difference as identified in the monthly control account reconciliation for account code 9111, being the difference between the amounts uploaded from the Galaxy cash receiving system, and the amounts uploaded from the bank statements, to gain assurance over completeness of amounts recognised as income in the financial statements.



### Deloitte view

We have concluded that commercial income has been recognised in accordance with the Charities SORP and FRS102.

# Significant risks (continued)

## Risk 2 – Investment Grants

### Risk identified

When HES was formed on 1 October 2015, the organisation assumed the statutory responsibility from Historic Scotland (HS) to deliver grants, mainly to charitable trusts, as well as local authorities and individuals. As this is a material expenditure stream for HES, there is a significant risk associated with the accurate recording of these grants.

From our testing in 2016/17, we identified an uncorrected misstatement in relation to the recognition of investment grants where a number of grants were found to have been accounted for incorrectly. Management undertook a full review of all investment grants, which quantified the total error as £638k. Systematic errors were found as a result of reconciliation errors in determining year-end accruals and commitments. We therefore recommended that the finance team should take primary responsibility for overseeing/performing the reconciliation process for financial statement purposes going forward to ensure year-end liabilities have been recognised in line with the relevant accounting standards.

As a result of the history of errors, this remained a significant risk area in 2017/18.



### Key judgements and our challenge of them

Under the Charities SORP (FRS102) the award of a grant is recognised as a liability when the criteria for a constructive obligation are met, payment is probable, it can be measured reliably, and there are no conditions attaching to its payment that limit its recognition.



### Deloitte response

We have performed the following:

- obtained an understanding of the design and implementation of the key controls in place in relation to awarding and recognition of investment grants; and
- tested a sample of investment grant accruals, commitments and retentions at the year-end to assess whether they have been accounted for in accordance with the Charities SORP.

	Due within 1 year £'000	Due in more than 1 year £'000
Grants payable (accruals)	8,566	-
Grants commitments	8,779	6,991
Grants retentions	1,063	615
<b>Total</b>	<b>18,408</b>	<b>7,606</b>
<b>Total liabilities</b>	<b>26,014</b>	

### Deloitte view

We have concluded that that the investment grants liabilities have been accounted for in accordance with the Charities SORP and no errors have been identified.

We are pleased to note that improvements have been made in the year to the controls around the accounting for grants.

# Significant risks (continued)

## Risk 3 - Management override of controls



### Risk identified

In accordance with ISA 240 management override is a significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override controls for specific transactions.

The key judgements in the financial statements are those which we have selected to be the significant audit risks around recognition of income, treatment of investment grants and treatment of restricted/ unrestricted funding. These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.

### Deloitte view

We have not identified any significant bias in the key judgements made by management.

### Deloitte response

We have considered the overall sensitivity of judgements made in preparation of the financial statements, and note that:

- HES and HESe's results throughout the year were projecting an over commitment against budget, reflecting the fact that the Scottish Government was reducing the Grant in Aid (GiA) as a result of HES generating more commercial income. This was closely monitored and whilst projecting over-commitments, the underlying reasons were well understood and regular discussions were held with Scottish Government;
- SCRAN ceased trading in the 2015/16 therefore there were no transactions in 2017/18 other than a limited number to clear balances; and
- senior management's remuneration is not tied to particular financial results.

We have considered these factors and other potential sensitivities in evaluating the judgements made in the preparation of the financial statements.

### Significant transactions

We did not identify any significant transactions outside the normal course of business or any transactions where the business rationale was not clear.

### Journals

We have made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.

We performed design and implementation testing of the controls in place for journal approval. We have used Spotlight data analytics tools to test a sample of journals, based upon identification of items of potential audit interest. We have not identified any issues with journal postings from our testing.

### Accounting estimates

In addition to our work on key accounting estimates discussed above, our retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements has been completed with no issues noted.

# Significant risks (continued)

## Risk 4 – Categorisation and application of funds - Restricted and unrestricted income and expenditure

### Risk identified

Practice Note 11 *The Audit of Charities in the United Kingdom (revised)* issued by the Auditing Practices Board states that restricted funds should be a presumed significant risk for all charities. As a result, we are required to examine the movement in the restricted funds from the Charity to ensure that the restricted funds have been accounted for correctly.



### Key judgements and our challenge of them

HES must ensure that income is recorded correctly between restricted and unrestricted funds and expenditure is incurred in accordance with relevant charities legislation, the objects of the Charity and the specific fund balances. The key area of restricted funding for HES is the Heritage Lottery Fund monies received in relation to the Engine Shed Project.



### Deloitte response

In considering the risk of restricted funds being accounted for incorrectly as unrestricted funds, we have performed the following audit procedures that directly address this risk:

- obtained an understanding of the design and implementation of the key controls in place in relation to the treatment of restricted funds;
- as part of our income testing, we have considered if any restrictions apply;
- we carried out tests of detail on restricted fund expenditure, and tied this back to the supporting documentation for the restricted income used to fund the expenditure to assess whether the restrictions of the income have been met; and
- we have also assessed the presentation and classification of transfers between restricted and unrestricted funds.

	Heritage Lottery Fund £'000	Other Restricted Funds £'000
Balance at 1 April 2017	3,118	1,107
Income	445	756
Expenditure	(783)	(1,443)
Transfers	-	289
<b>Balance at 31 March 2018</b>	<b>2,780</b>	<b>709</b>
<b>Total Restricted Funds</b>	<b>3,489</b>	

### Deloitte view

We have concluded that the categorisation and application of restricted funds is in accordance with the Charities SORP. We have noted a minor control deficiency in relation to how restricted funds are accounted as noted on page 16, however, accept that the majority of HES income is unrestricted so this does not have any impact on our opinion.

# Other significant findings

## Internal control and risk management

During the course of our audit we have identified a number of internal control and risk management findings, which we have included below for information. Detailed recommendations and agreed management action are included within the appendices of this report.

Area	Observation	Priority
IT information leakage	<p>We recognise the work undertaken by HES in preparing for GDPR compliance. We did however identify the following gaps in internal control relating to information leakage which we recommend should be updated:</p> <ul style="list-style-type: none"><li>• There is no formal data leakage risk assessment performed;</li><li>• There are no controls over portable media, e.g. USB drives and laptops; and</li><li>• There are no specific Data Loss Prevention tools.</li></ul> <p>We are aware that HES's Information Governance (IG) team is currently working with IT to plan how it improves its IG through IT controls and therefore has a clear understanding of the risks and is putting in place an action plan to mitigate the risks.</p>	High
Stock	<p>Given the level of stock and number of stock locations, the misappropriation of stock is a risk that needs to be managed. We identified the following issues when performing stock count procedures at the year-end as part of our audit of HESe:</p> <ul style="list-style-type: none"><li>• A system upgrade to the stock system (Counterpoint) were carried out around the time of us attending the stock count for the main warehouse, being the week before the year-end. This brings with it a risk that errors could occur impacting on the final year-end results. The finance team should be consulted to agree mutually agreeable dates for any such system upgrades; and</li><li>• A number of discrepancies were identified between amounts counted by Deloitte and the amounts recorded on Counterpoint. Whilst not material, this does bring into question to control around holding and managing stock., for example ensuring any transfers between different stock locations are properly reflected in the system and that there are clear locations for holding stock at each site.</li></ul>	High

Low Priority

Medium Priority




High Priority

The purpose of the audit was for us to express an opinion on the financial statements. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters being reported are limited to those deficiencies that we have identified during the audit and that we have concluded are of sufficient importance to merit being reported to you.



# Other significant findings (continued)

## Internal control and risk management (continued)

Area	Observation	Priority
Restricted funds	<p>In accordance with Practice Note 11 The Audit of Charities in the United Kingdom, there is a presumed risk related to specific income that is not used in line with the donor's wishes. This is reflected in the distinction between restricted/unrestricted funds. During the audit we identified that there are limited control in place during the year to identify whether income or expenditure relates to restricted or unrestricted funds. While it is accepted that the majority of HES's income is unrestricted, a system should still be in place to ensure any restricted income is properly accounted for. No errors have been identified from our testing of income and expenditure treated as restricted in the year.</p>	
Property valuations	<p>From our review of the property valuations performed in the year, we identified the following issues:</p> <ul style="list-style-type: none"><li>• The valuer incorrectly excluded VAT in their valuation of the Engine Shed (note this has subsequently been amended). The VAT status of any specialist property should be clearly communicated to the valuer in advance of any future valuations;</li><li>• Assets not subject to a formal valuation in the year were indexed CPI. This is not considered the most appropriate indices to use as valuation of real estate assets or changes in value year on year do not generally follow CPI indices. We recommend that in future, a more appropriate index is used, e.g. BCIS, which we have seen in other public sector bodies; and</li><li>• Insufficient information was provided by the valuer with their report, in support of the inputs used in the valuation, for example rent, yields, capital rates or market evidence.</li></ul>	
Fixed Asset Register	<p>From our testing of fixed asset disposals, we identified one disposal processed in 2017/18 that had been made in 2008. This is due to the site manager in the area not communicating this particular disposal. We are satisfied that the value of this disposal was nil as it has been fully depreciated, but does highlight a need for the data held in the fixed asset register to be fully cleansed to ensure it actually reflects assets still in use.</p>	

Low Priority

Medium Priority

High Priority

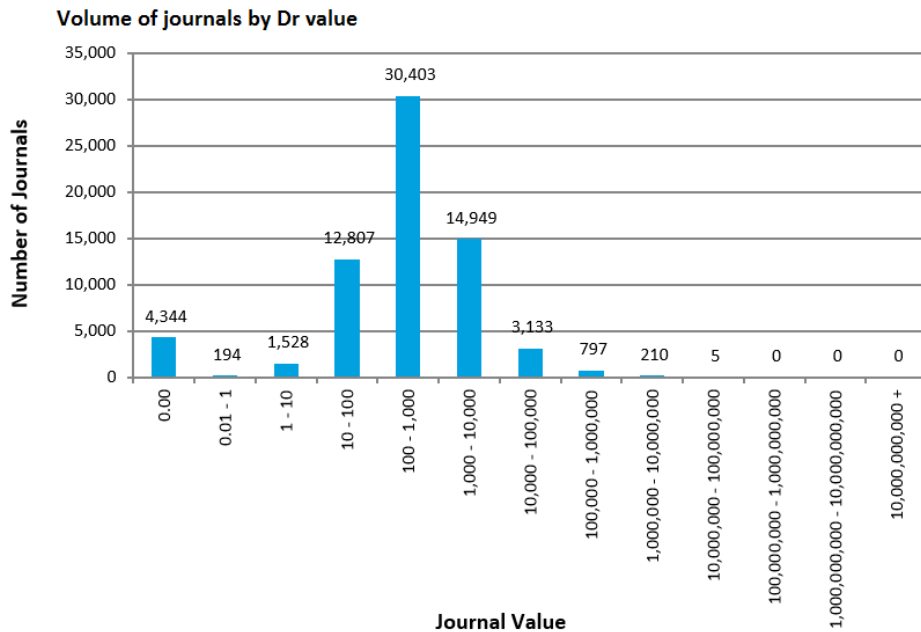


# Other significant findings (continued)

## Insights delivered

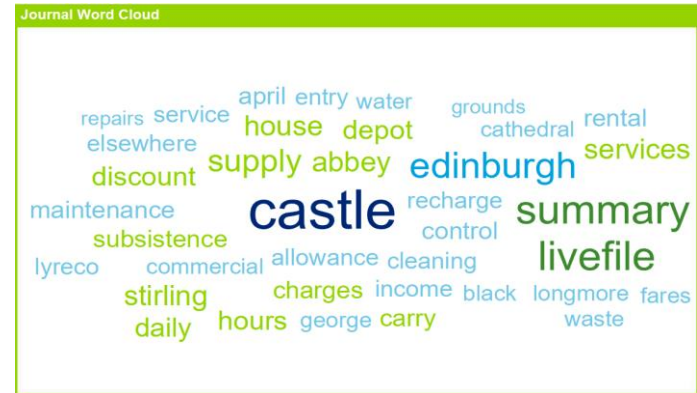
Whilst performing our journal entry testing, the audit team have noted the below journal insights.

The 'Number of Journals' v 'Journal Value' chart below shows the total number of journals posted for each value banding, which could suggest a significant degree of resources is expended throughout the year to process a relatively insignificant total value of journal postings.

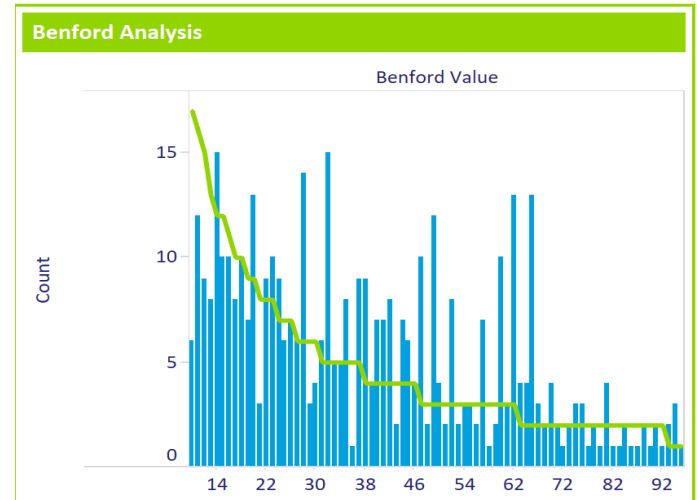


As an additional check for unusual transactions, we performed a Benford's Analysis as shown across, which identifies unusual number distributions, and note that the HES' postings did not differ from what was expected by a statistically significant amount.

We performed a review of the posting frequency of staff with access to the system and noted that all staff have taken long holidays (>5 consecutive days) in the year, reducing concern for potential fraudulent behaviour or finance function stress and fatigue.



The word cloud above is a simple illustration identifying the most common words which appear within manual journal postings throughout the year. The largest words are in line with expectations.



# Our audit report

## Other matters relating to the form and content of our report

Here we discuss how the results of the audit impact on other significant sections of our audit report. The revisions to ISA (UK) 700 have changed the form and content of audit report, including how different sections are presented.



### **Our opinion on the financial statements**

Our opinion on the financial statements is unmodified.



### **Material uncertainty related to going concern**

We have not identified a material uncertainty related to going concern and will report by exception regarding the appropriateness of the use of the going concern basis of accounting.



### **Emphasis of matter and other matter paragraphs**

There are no matters we judge to be of fundamental importance in the financial statements that we consider it necessary to draw attention to in an emphasis of matter paragraph.

There are no matters relevant to users' understanding of the audit that we consider necessary to communicate in an other matter paragraph.



### **Other reporting responsibilities**

The Annual Report is reviewed in its entirety for material consistency with the financial statements and the audit work performance and to ensure that they are fair, balanced and reasonable.

### **Opinion on regularity**

In our opinion in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Our opinion on matters prescribed by the Auditor General for Scotland are discussed further on page 19.

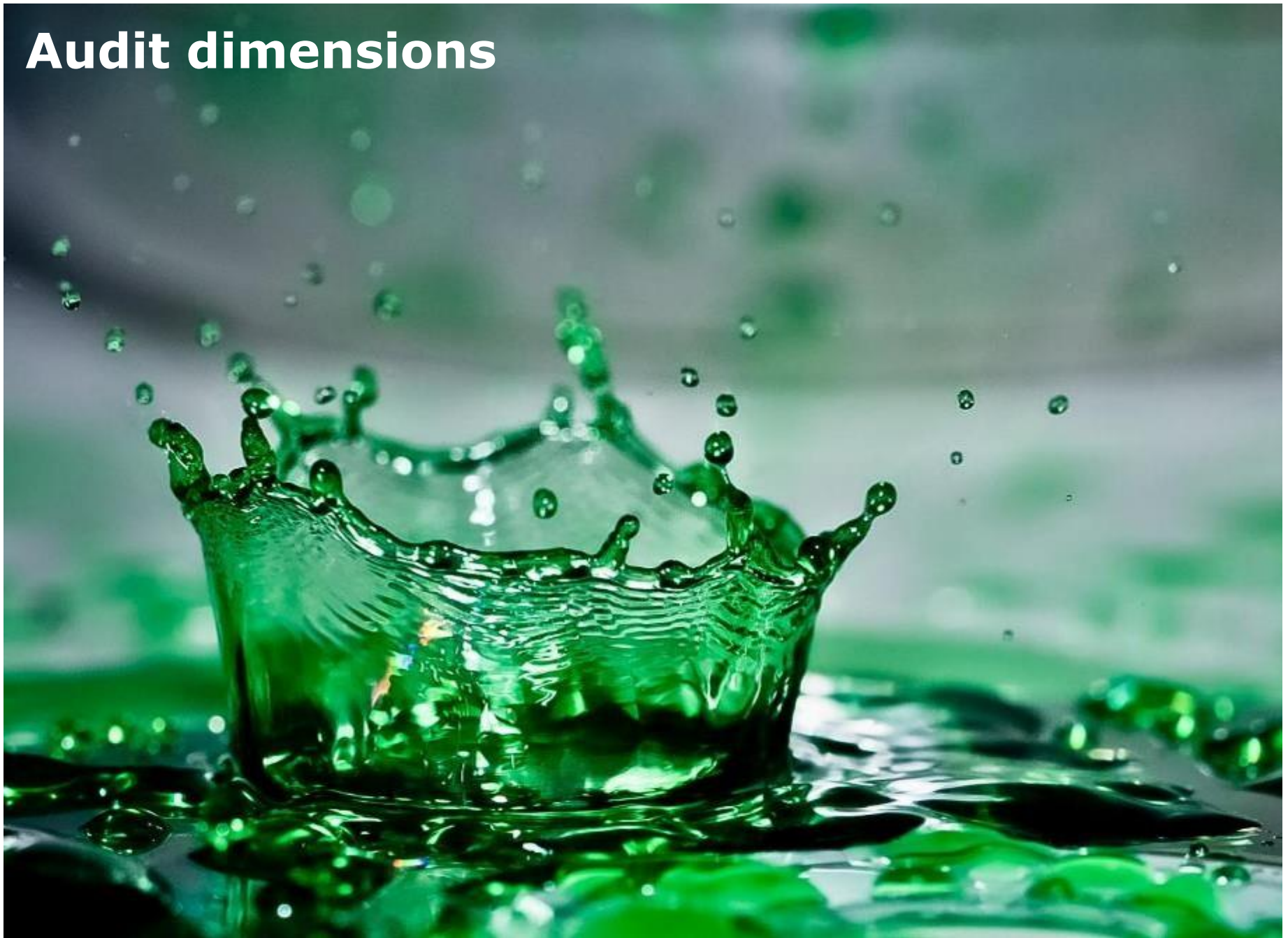


# Your annual report

We welcome this opportunity to set out for the Audit, Risk and Assurance Committee our observations on the annual report. We are required to provide an opinion on the remuneration report, the annual governance statement and whether the management commentaries are consistent with the disclosures in the accounts.

	Requirement	Deloitte response
Trustees' report	<p>The SORP's requirements that all charities must follow are set out in the following headings:</p> <ul style="list-style-type: none"><li>• Objectives and activities;</li><li>• Achievements and performance;</li><li>• Financial review;</li><li>• Structure, governance and management;</li><li>• Reference and administrative details;</li><li>• Exemptions from disclosure; and</li><li>• Funds held as custodian trustees on behalf of others.</li></ul>	<p>We have assessed whether the Trustees' report has been prepared in accordance with the Charities SORP.</p> <p>We have also read the Trustees' report and confirmed that the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading.</p>
Annual Governance Statement	<p>The FReM requires a governance statement to be published with the financial statements and guidance on content is provided in the Scottish Public Finance Manual (SPFM).</p>	<p>We have assessed whether the information given in the Annual Governance Statement is consistent with the financial statements and has been prepared in accordance with the accounts direction. No exceptions noted.</p>
Remuneration and Staff Report	<p>Charitable Non-Departmental Public Bodies (NDPBs) are not required to comply with the requirements of chapter 5 of the FReM, therefore the remuneration disclosures in the notes, as required by the Charities SORP is all that is required. These disclosures replace the need for a separate remuneration report.</p> <p>HES has, however, chosen to publish a separate remuneration and staff report in accordance with the requirements of the FReM to aid transparency.</p>	<p>We have audited the auditable parts of the remuneration and staff report with no issues noted.</p> <p>We have confirmed that it has been prepared in accordance with the FReM.</p>

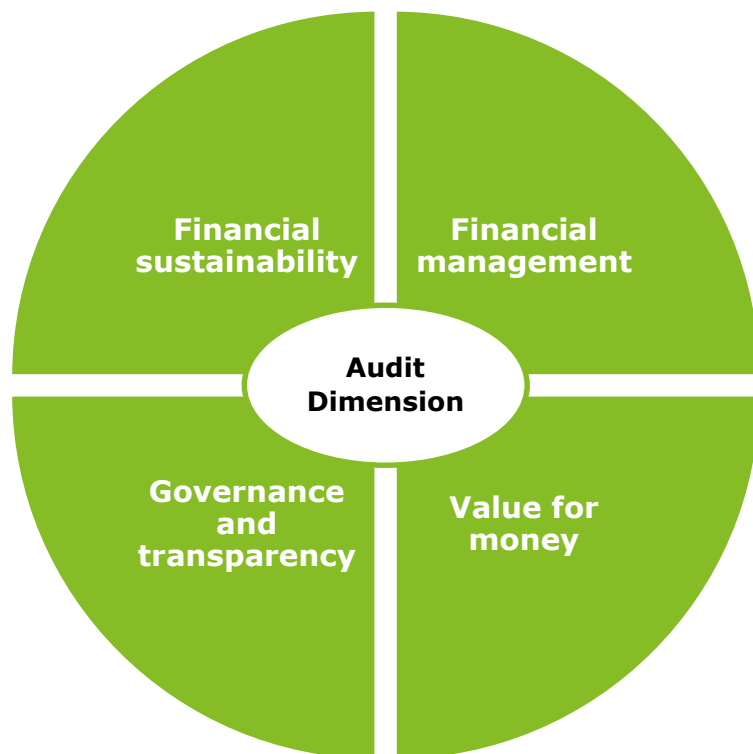
# Audit dimensions



# Audit dimensions

## Overview

Public audit in Scotland is wider in scope than financial audit. This section of our report sets out our findings and conclusion on our audit work covering the following area. Our report is structured in accordance with the four audit dimensions, but also covers our specific audit requirements on best value and specific risks as summarised below.



### Best Value (BV)

The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

We have considered the accountable officers' duty to secure BV as part of the governance arrangements considered as part of the audit dimensions work.

### Specific risks (SR)

As set out in our Annual Audit Plan, Audit Scotland had identified a number of significant risks (SRs) faced by the public sector which we have considered as part of our work on the four audit dimensions.

- SR 1** – EU Withdrawal
- SR 2** – New Financial Powers
- SR 3** – Ending public sector pay cap
- SR 4** – Cyber security risk
- SR 5** – Openness and transparency

# Audit dimensions (continued)

## Financial sustainability

### Audit dimension

As part of the annual audit of the financial statements, we have considered the appropriateness of the use of the going concern basis of accounting. Going concern is a relatively short-term concept looking forward 12 to 18 months from the end of the financial year. Financial sustainability interprets the requirements and looks forward to the medium (two to five years) and longer term (longer than five years) to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

#### Areas considered



- The financial planning systems in place across the shorter and longer terms.
- The arrangements to address any identified funding gaps.
- The affordability and effectiveness of funding and investment decisions made.
- Workforce planning.

#### Deloitte response



We have monitored HES's actions in respect of its short, medium and longer term financial plans to assess whether short term financial balance can be achieved.

Following on from a recommendation made in 2016/17, we have also followed up progress on the development of the longer term (5-10 years) financial strategy, and finally we have also considered if investment is effective.

#### Deloitte view

A draft financial strategy was presented to the Board in May 2018 for comment. From a review of the draft, we are satisfied that this addresses all of the key features of best practice. In the shorter term, the budget is anticipating a break-even position for 2018/19 with potential funding gaps identified in 2019/20 (£1.22m) and 2020/21 (£5.50m). If no action is taken, the potential funding gap could increase to £14.7m. The strategy clearly sets out possible avenues for intervention to bridge the funding gap into future years. We recommend that this is finalised as soon as possible, with a clear plan of actions required to bridge the gap. This should be clearly linked to any transformation plan. It is important that HES consider the supporting infrastructure required to deliver the changes required.

Subject to this being addressed, and as discussed further on page 23 we are satisfied that annual financial planning and monitoring is applied on a robust basis, with accurate reporting throughout the year, and that long term financial planning is also being implemented. Deloitte will follow up progress of HES against the finance strategy in the 2018/19 audit.

# Audit dimensions (continued)

## Financial sustainability (continued)

### Short term financial position

HES generated £97.292m income in **2017/18** (£94.946m in 2016/17) and with costs of £96.273m (£85.031m in 2016/17) operated successfully within its financial envelope. The principal sources of income were from admission and retail income generated from historic properties which increased significantly in the year to £50.9m (£42.4m in 2016/17), largely as a result of increased visitor numbers. The year ended with net commercial income being £7.09m higher than budgeted, which resulted in HES being able to reduce cash grant in aid by over £5.0m from £42.200m to £37.145m.

The **2018/19** budget was presented to the Board on 22 February 2018. This budgeted total expenditure of £98.2m. Excluding budgeted self-generated income of £57.1m the net expenditure is £41.1m (cash £38.6m and non-cash £2.5m) which needs to be met from SG funding. This is an increase of £1.455m on the actual cash funding received in 2017/18.

In setting its budget the Board has recognised that a number of risks exist, such as the impact of market conditions on commercial income, and investment plan slippage from 2017-18 which may result in projects planned for 2018-19 not being affordable.

The budget includes pay awards which have been aligned to the thresholds set out by the Cabinet Secretary in the Stage 1 debate on 31 January 2018. This also includes a cost of living increase effective from 1st April 2018 which has been budgeted for at either 2% or 3% depending on an individual's salary.

### Medium to long term financial sustainability

While we are satisfied that annual financial planning and monitoring is applied on a robust basis, with accurate reporting throughout the year, we did identify in the 2016/17 audit the importance that HES progresses medium and longer term financial planning as a matter of urgency. This is still in draft form and was presented to the Board for comment in May 2018. The recommendation to finalise and implement this medium to longer term financial strategy therefore still stands.

From a review of the draft, we are satisfied that this addresses all of the key features of best practice, however, should be clearly linked to any transformation plan. It is important that HES consider the supporting infrastructure required to deliver the changes required such as:

- Its change management approach;
- Tools and templates to assess whether intended benefits of change have been achieved; and
- Whether it requires external specialists for any aspects of the plan.



# Audit dimensions (continued)

## Financial management

### Audit dimension

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



#### Areas considered

- Budgetary control system.
- Systems of internal control.
- Financial capacity and skills.
- Arrangements for the prevention and detection of fraud.



#### Deloitte response

We have reviewed the budget monitoring reporting to HES during the year and the year-end position to assess whether financial management and budget setting is effective.

We have evaluated the key financial systems and internal control as part of our consideration of the design and implementation of key controls in our financial statements audit work and considered the work of internal audit.

We have reviewed the plans made by management to ensure that the capacity and skills within the senior management of the finance team are sufficient.

We have reviewed the Board's arrangements for the prevention and detection of fraud and irregularities.

	2017/18 Budget £'000	2017/18 Actual £'000	2017/18 Variance £'000
Gross Expenditure	97,790	96,738	1,052
Income	89,509	100,016	10,507
<b>Deficit/ (Surplus)</b>	<b>8,281</b>	<b>(3,278)</b>	<b>11,159</b>

The actual surplus, £3.3m, differs to the surplus reported on the face of the SoFA, £1.019m, due to the differences in accounting for grants in line with the Charity SORP versus what is reported to the Scottish Government (SG). A reconciliation is provided in the annual report on page 16.

#### Deloitte view

The Board has effective financial planning and management arrangements in place.

We are satisfied HES has strong financial monitoring arrangements and is robust enough to sufficiently capture any changes in the achievement of financial targets.

We also note a significant improvement from last year in improving the capacity of the finance team.

We are satisfied HES has appropriate arrangements for the prevention and detection of fraud and corruption.



# Audit dimensions (continued)

## Financial management (continued)

### Systems of internal financial control

As discussed further on page 15, we have evaluated the key financial systems and internal control to determine whether they are adequate to prevent misstatements in the annual accounts. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.

No material weaknesses have been identified from our audit work performed. Insights have been made (see page 15) where we have identified areas for improvement.

### Finance team capacity

In our 2016/17 report we recommended that the capacity of the finance team should be reviewed to ensure that there is a strong control environment in place. We are pleased to note that good progress has been made with this and following the permanent appointment of the Director of Finance in August 2017, a clear finance team structure has been approved. A Head of Financial Business Support and Head of Finance have recently been appointed. Two distinct teams covering finance business partnering and financial accounting, operations and compliance are now being filled either through internal restructure or recruitment.

### *Fraud and irregularity*

We have reviewed HES's arrangements for the prevention and detection of fraud and irregularities. Overall we found the arrangements to be operating effectively.

In accordance with Audit Scotland planning guidance, we are required to monitor HES's participation and progress in the National Fraud Initiative (NFI) during 2016/17 and 2017/18. An NFI audit questionnaire was completed and submitted to Audit Scotland on 28 February 2018, which concluded that HES was fully engaged in the exercise.

# Audit dimensions (continued)

## Governance and transparency

### Audit dimension

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making, and transparent reporting of financial and performance information.

### Areas considered



- Governance arrangements.
- Scrutiny, challenge and transparency on decision making and financial and performance reports.
- Quality and timeliness of financial and performance reporting
- Accountable officers' duty to secure Best Value

### Deloitte response



We have reviewed how the governance arrangements have developed following the significant period of change in 2015/16. We note that the financial processes in HES follow the requirements of the SPFM and limits of delegation agreed with the Scottish Government. There is currently no interpretation of these in the form of tailored financial regulations. Work is ongoing with the drafting of the tailored financial regulations by the Finance Compliance Manager.

We have reviewed the financial and performance reporting to the Board during the year and noted no issues with the quality and timeliness of these reports.

We have reviewed the minutes of the ARAC and Board meetings to assess the effectiveness of the governance arrangements and the level of scrutiny and challenge. Our attendance at the ARAC has also informed our work in this area.

### Deloitte view

The Board's governance framework and arrangements, including decision making and scrutiny, are appropriate and support good governance and accountability. We are satisfied that there are appropriate arrangements in place for securing best value.

The Board has strong executive leadership. The relationship between board members and officers is good, and there is evidence of effective challenge from committee meetings. The Board is open and transparent in its decision making with all minutes available through the Board's website.

The quality and timeliness of financial performance reporting is good with timely reporting to SMT on a monthly basis and the Board on a quarterly basis.

# Audit dimensions (continued)

## Governance and transparency (continued)

### Governance arrangements

We reviewed the Board's governance and accountability arrangements which included:

- Confirming that the governance framework and governance arrangements, including decision-making and scrutiny, are regularly reviewed and updated to ensure they remain effective;
- Assessing the effectiveness of decision-making to ensure it is balanced by effective scrutiny and challenge by those independent of the body;
- Confirming that there is effective scrutiny and challenge in place over policy decisions, service performance and programme management;
- Confirming that decision makers have the information they need to scrutinise, challenge and make best value and transparent decisions; and
- Ensuring that it is clear what decisions have been made, who make them and the rationale supporting the decisions.

We have concluded that overall the board's arrangements are appropriate and adequate in that they support good governance and accountability.

We noted in our planning paper presented to the ARAC in January that given the number of changes in senior leadership during 2017, there was a risk that the skills and continuity are not sufficient for effective scrutiny and challenge. We have monitored this during the course of the audit, through attendance at ARAC and review of minutes and noted no issues, with the new Senior Management Team operating effectively together.

### Internal Audit

The audit team has completed an assessment of the independence and competence of the internal audit department and reviewed their work and findings. We do not have any significant findings.

During the year, we have reviewed all internal audits presented to the Audit, Risk and Assurance Committee and the conclusions have helped inform our audit work, although no specific reliance has been placed on the work of internal audit.

From our review of the internal audit reports issued during 2017/18, we have not noted any "high" risk graded recommendations that would have an impact on our audit approach. No instances of fraud have been identified as a result of these issues.

We are also pleased to note the substantial assurance provided in 2017/18 by internal audit with respect to risk, management, control and governance arrangements.

We note that the internal audit reports reviewed in the period relate to audits completed by the Scottish Government internal audit function. The internal audit function has undergone a significant transition in the period with the introduction of a newly formed in-house function and the appointment of the new Head of Internal Audit and Business Improvement.

### Risk management

A developed and integrated approach to risk management is a key feature of a robust system of internal control.

The corporate risk register is linked to HES's corporate objectives. ARAC and the Board receives regular reports on the corporate risk register, which provides updates on action taken by to mitigate risks.

We have concluded that risk management arrangements are satisfactory and appropriate.

# Wider scope requirements (continued)

## Value for money

### Audit dimension

Value for money is concerned with using resources effectively and continually improving services.



### Areas considered

- Value for money in the use of resources
- Link between money spent and outputs and the outcomes delivered
- Improvement of outcomes
- Focus on and pace of improvement



### Deloitte response

From our 2016/17 audit work we concluded that the Board had a well established performance management framework in place with performance regularly considered by the SMT and the Board.

We have gained an understanding of HES'S self-evaluation arrangements to assess how it demonstrates value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.

### Performance management

HES performance for 2017-18 is measured against targets laid out in the 2016-2019 Corporate Plan and the 2017-2018 Annual Operating Plan. These measure internal key performance indicators, as well as the wider HES contribution to the national performance framework, and identify direct and indirect contributions to national performance outcomes.

The Board has reported successful delivery of 96% of Year 2 KPIs. This includes significantly exceeding the target of 4m visitors with numbers surpassing 5m in the year. The Trustees report provides information on areas where the KPIs have not been met and therefore work is still under development. This includes areas where HES can work with local communities and Community Planning Partnerships, where policies and guidance are due to be published to help meet these targets.

### Deloitte view

There is a clear framework in place to ensure that HES performance is monitored and reported. This is based on five key HES themes of lead, understand, protect, value and perform. It is clear that the Board has continued to make substantial progress in its second year of applying the 2016-2019 Corporate Plan.

As reported in our 2016/17 report, we recommend increased visibility of resource and financial planning being based on the evidenced based contribution to key HES priorities and national performance outcomes. This would link resource planning to the outcomes achieved with clear supporting KPI's. We understand from management that work in developing this is at an early stage.

# Wider scope audit work (continued)

## Specific risks

In accordance with our Audit Plan, we have considered the specific risks identified by Audit Scotland as part of our audit as follows:

Risk identified	Response
<b>EU Withdrawal</b>	<p>The UK is expected to leave the European Union (EU) on 29 March 2019, followed by a transition period to the end of 2020. There are still a lot of uncertainties surrounding the terms of the withdrawal agreement but the outcome will inevitably have significant implications for devolved governments in Scotland and for Scottish public sector bodies.</p> <p>Given the scale of the potential implications and possible timescales for implementing changes, it is critical that public sector bodies are working to understand, assess and prepare for the impact on their organisation. This is likely to include consideration of three areas:</p> <p><b>Workforce:</b> the extent to which potential changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour.</p> <p><b>Funding:</b> the extent to which potential changes to funding flows including amounts anticipated under existing EU funding programmes, are likely to affect the finances of the organisation and the activity that such funding supports.</p> <p><b>Regulation:</b> the extent to which potential changes to regulation across a broad range of areas currently overseen at an EU level are likely to affect the activity of the organisation.</p> <p>The main concerns are with regards to access to the EU labour force which staffs a significant portion of HES' seasonal staff, and to a lesser extent the permanent staff. HES should continue to monitor the potential impact as the details develop.</p>
<b>New financial powers</b>	<p>The Scottish Parliament's new financial and social security powers and responsibilities from the 2012 and 2016 Scotland Acts are fundamentally changing the Scottish public financials. The Scottish Government has published its medium-term financial outlook in 2018 in response to recommendations in the Budget Process Review Group final report, and has made a number of other commitments to improve financial management and help Parliamentary scrutiny of decisions. This builds on the outcomes based approach</p> <p>As a result of this, there is an expectation that public bodies will be seen before subject committees of the Parliament more often. HES should therefore use this as an opportunity to make comment within their annual reports beyond the compliance requirements to clearly articulate their achievements against outcomes and future plans. This is clearly documented in the Trustee's Report with reference to HES' contribution to the National Performance Framework and performance against the KPIs set out in the Annual Operating Plan for 2017/18. As noted on page 28, HES now needs to increase its visibility of resource and financial planning being based on the evidenced based contribution to key HES priorities and national performance outcomes. We understand from management that work in developing this is at an early stage.</p>

# Wider scope audit work (continued)

## Specific risks (continued)

Risk identified	Response
<b>Cyber security risk</b>	<p>From our audit work, we can confirm that there is a structured approach to cyber security which guides its activity and expenditure. This includes, but is not limited to:</p> <ul style="list-style-type: none"> <li>- a policy from Information Governance that users have to sign up to that they have read and understood it.</li> <li>- SG Cyber Essentials strategy;</li> <li>- cyber security risks as standing items on the Corporate Risk Register for discussion at committee meetings;</li> <li>- designated persons tasked with responsibility for cyber security at various levels of management; and</li> <li>- A critical incident management process which links to the SG security incident management process;</li> </ul> <p>We do note, however, some control weaknesses, which have been flagged as insights on page 16.</p>
<b>Ending public sector pay cap</b>	<p>As discussed on page 23, the 2018/19 budget includes pay awards which have been aligned to the thresholds set out by the Cabinet Secretary in the Stage 1 debate on 31 January 2018.</p>
<b>Openness and transparency</b>	<p>From our audit work, we are satisfied that HES is appropriately open and transparent in its operations and decision making. This includes public performance reporting on the HES website, as well as publication of the Annual Operating Plan, Corporate Plan, and other key documents.</p>

# Appendices





# Purpose of our report and responsibility statement

## Our report is designed to help you meet your governance duties

### What we report

Our report is designed to help the Audit, Risk and Assurance Committee and the Board discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK) to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Annual Report.
- Our internal control observations
- Other insights we have identified from our audit

### What we don't report

As you will be aware, our audit was not designed to identify all matters that may be relevant to the Board.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

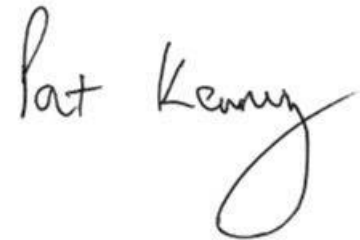
We welcome the opportunity to discuss our report with you and receive your feedback.

### The scope of our work

Our observations are developed in the context of our audit of the financial statements.

We described the scope of our work in our audit plan and the supplementary "Briefing on audit matters" circulated separately.

This report has been prepared for the Audit, Risk and Assurance Committee and Board, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.



for and on behalf of Deloitte LLP  
Glasgow  
16 July 2018



# Audit adjustments

## Summary of corrected and uncorrected misstatements and disclosure deficiencies

### Corrected misstatements

The following corrected misstatement has been identified up to the date of this report which management have agreed to adjust in the final accounts. The net impact of this is an increase of £1.2m in the net income/ expenditure for the period.

		Debit/ (credit) SOFA £m	Debit/ (credit) in net assets £m	Debit/ (credit) prior year reserves £m	Debit/ (credit) in income £m	If applicable, control deficiency identified
<b>Misstatements identified in current year</b>						
Adjustment to valuation of Engine Shed	[1]	(1.2)	1.2			N/A
<b>Total</b>		<b>(1.2)</b>	<b>1.2</b>			

[1] An adjustment has been made to the valuation of the Engine Shed asset as a result of an incorrect land valuation and the incorrect exclusion of VAT.

### Uncorrected misstatements

No uncorrected misstatements have been identified from our audit work performed to date.

### Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable audit committees to evaluate the impact of those matters on the financial statements. We have noted no material disclosure deficiencies in the course of our audit work to date.

# Action plan

## Recommendations for improvement

Area	Recommendation	Management Response	Director Responsible	Responsible person	Target Date	Priority
IT - information leakage	<p>HES should implement controls to address the risk of information leakage including:</p> <ul style="list-style-type: none"> <li>Ensuring formal data leakage risk assessment is performed;</li> <li>Implementing controls over portable media, e.g. USB drives and laptops; and</li> <li>Implementing specific Data Loss Prevention tools.</li> </ul>	<p>IG is currently working with IT to plan how we improve our IG through IT controls. Specifically looking at how we can align the approach to data loss prevention from an IT and IG perspective to provide training, awareness raising and technical controls to reduce the risk. Although a formal risk assessment around data leakage has not been performed, HES has an ISO 27001 gap analysis which highlights specific failings which HES are aware of. This was performed during 2017-18 and will be updated once an Information Security Manager has been appointed. Controls over USB devices is one of the first areas to be reviewed during 2018-19.</p>	Director of Finance	Head of Information Governance	March 2019	Medium
Restricted versus unrestricted funds classification	<p>A formal control should be put in place to ensure that funds are correctly categorised as restricted/unrestricted from the outset when input in the financial system.</p> <p>In addition, a control should be put in place to ensure all staff involved are alerted to the specific conditions attached to the funds.</p>	<p>Further controls will be built into the requirements for CMIS. Interim measures will be introduced for Integra (current finance system) and arrangements put in place for communicating restrictions.</p>	Director of Finance	Head of Finance	March 2019	Low

# Action plan (continued)

## Recommendations for improvement (continued)

Area	Recommendation	Management Response	Director Responsible	Responsible person	Target Date	Priority
Fixed asset valuations	<p>The VAT status of any specialised operational assets should be communicated to both the valuer to ensure the appropriate inclusion/exclusion of VAT in the valuation.</p> <p>HES should also consult with its valuer regarding an appropriate benchmark to use for indexing its assets in years where they are not subject to a formal revaluation.</p>	Agreed	Director of Finance	Head of Finance	March 2019	Medium
Stock controls	<p>HES should ensure that future upgrades to the stock system (Counterpoint) are not carried out at the year-end so as not to impact on year-end balances.</p> <p>HES should also ensure that physical stock controls at individual sites are put in place, particularly with regards to ensuring any stock movements are captured in the stock/till system, e.g. even to capture movements between two separate gift shops at Edinburgh/Stirling castle.</p>	<p>Agreed. The upgrade of the stock system was not planned to be carried out at the year end, however, factors out with the control of both Finance and C&amp;T resulted in delays.</p> <p>Stock controls and procedures are already in place. Staff involved in the management of stock will be reminded of the need to ensure that all physical movements of stock are recorded in the stock system</p>	Director of C&T	Head of Retail	December 2018	Medium

# Action plan (continued)

## Recommendations for improvement (continued)

Area	Recommendation	Management Response	Director Responsible	Responsible person	Target Date	Priority
Fixed Asset Register	To ensure the accuracy and completeness of fixed asset records, we recommend that a full data cleansing exercise is carried out on Britannia ahead of transitioning to the new integrated ERP system, CMIS, and that the importance of staff communicating any changes in fixed assets to the Finance team in the annual return is re-emphasised.	Agreed	Director of Finance	Head of Finance	March 2019	Medium

# Action plan (continued)

## Follow up of 2016/17 recommendations (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
Property Valuations	<p>The following points should be considered when agreeing the work to be performed by the valuer for 2017/18:</p> <ul style="list-style-type: none"> <li>We recommend that the valuer provides key valuation inputs including rent, yields, capital rates or market evidence within the schedules provided to provide greater transparency over the key considerations.</li> <li>We recommend that HES requests that the valuations with supporting valuation report and appendices are issued shortly after the valuation date, even if these are in draft form, to be finalised shortly thereafter.</li> </ul>	<p>Management will discuss this recommendation with the existing valuer, however, there may be a limit to what can be agreed as this is the final year of the contract and work has already commenced in relation to 2017/18 valuations. Once the new contract has been awarded, management will work with the new valuer to address this recommendation fully.</p>	Director of Finance	June 2018	Medium	<p><i>Not implemented</i> – at the time of the 2016/17 audit, HES had already started conversations with DVS regarding the valuation requirements for 2017/18. As such, this recommendation was not communicated to the valuer. Going forward, we recommend that this be implemented.</p> <p><b>Updated Management response:</b> Agreed</p> <p><b>Updated target date:</b> March 2019</p>

# Action plan (continued)

## Follow up of 2016/17 recommendations (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
Investment Grants	The finance team should take primary responsibility for overseeing/performing the reconciliation process for financial statement purposes going forward to ensure year-end liabilities have been recognised in line with the relevant accounting standards.	Agreed. Management will review the process and take action to ensure that the necessary controls are in place.	Director of Finance	April 18	High	<i>Fully implemented</i> - we can confirm from our work that the Finance team has taken full responsibility for overseeing this reconciliation process at the year-end. This has been fully implemented.
NFI	As a result of the outcome of the 2016/17 NFI exercise, we would recommend that HES review its controls around creditor payments to ensure that appropriate controls are in place to prevent similar errors happening in the future.	Agreed. Management will review processes and take action to ensure appropriate controls are in place.	Director of Finance	Mar 18	Medium	<i>Fully implemented</i> - all AP staff have been reminded at regular intervals throughout the year of the accuracy required when registering and matching invoices in Integra. All payment proposals are reviewed by the AP Manager and Fin Ops Manager prior to them being finalised for payment. Spot checks are also carried out by the 2 payment run approvers prior to them giving approval and posting the payment.

# Action plan (continued)

## Follow up of 2016/17 recommendations (continued)

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Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
NFI	We would recommend that the self appraisal checklist is shared with the Audit, Risk and Assurance Committee in future. We also noted that internal audit have not historically reviewed the approach to NFI and we would recommend that this is considered in future.	The NFI self-appraisal checklist will be shared with the Audit, Risk and Assurance Committee and an internal audit review of our approach to NFI will be considered as we develop our new three year internal audit plan.	Head of Internal Audit & Business Improvement	Mar 18	Medium	<i>Partially implemented</i> - the 2018/19 Plan has scheduled these reviews. These have not yet been undertaken - we will continue to monitor this and will review the report once the work has been completed by internal audit.  <b>Updated Management response:</b> Agreed  <b>Updated target date:</b> March 2019

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# Action plan (continued)

## Follow up of 2016/17 recommendations (continued)

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Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
Financial Sustainability	HES should progress medium and longer term financial planning as a matter of urgency.	Agreed. The Director of Finance is currently developing a financial strategy.	Director of Finance	May 18	High	<p><i>Partially implemented</i> – this is still in draft format. We recommend that finalisation of the plan is prioritised as a matter of urgency.</p> <p><b>Updated Management response:</b> Agreed. Board approval of the financial strategy is expected in November 2018. This is expected to be updated on an annual basis reflecting key changes in economic data and government funding.</p> <p><b>Updated target date:</b> November 2019</p>

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# Action plan (continued)

## Follow up of 2016/17 recommendations (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
Value for Money	Going forward, we would like to see increased visibility of resource and financial planning being based on the evidenced based contribution to key HES priorities and national performance outcomes. This would link resource planning to the outcomes achieved with clear supporting KPI's.	HES is progressing towards being able to link resource planning to outcomes sought and will investigate the feasibility of options to achieve this during 2017/18 and 2018/19.	Director of Finance	Mar 19	High	<p><i>Not implemented</i> – target date not yet due.</p> <p><b>Updated Management response:</b> HES is progressing towards being able to link resource planning to outcomes sought. The new CMIS system is expected to deliver on this objective and management are currently investigating feasibility of an interim solution which is aligned to the new National Performance Framework in advance of 2019-20.</p> <p><b>Updated target date:</b> March 2019</p>
Finance team	The capacity of the finance team should be reviewed to ensure that there is a strong control environment in place.	Agreed. The Finance team structure is currently being reviewed by the Director of Finance.	Director of Finance	Jun 18	High	<p><i>Fully implemented</i> – we can confirm that significant improvements have been made since the 2016/17 audit to the capacity of the finance team, which now includes 5 qualified accountants.</p>

# Fraud responsibilities and representations

## Responsibilities explained



### Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.



### Required representations:

We have asked the Board to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you are not aware of any fraud or suspected fraud that affects the entity or group.

We have also asked the Board to confirm in writing their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.



### Audit work performed:

In our planning we identified the risk of fraud in complying with recognition of grant income and management override of controls as a key audit risk for your organisation.

During course of our audit, we have had discussions with management and those charged with governance.

In addition, we have reviewed management's own documented procedures regarding fraud and error in the financial statements

We have reviewed the paper prepared by management for the Audit, Risk and Assurance Committee on the process for identifying, evaluating and managing the system of internal financial control.

### Concerns:

No concerns have been identified regarding fraud.



# Independence and fees

As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

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## Independence confirmation

We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.

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## Fees

The audit fee for 2017/18 is £75,742 in accordance with the range set by Audit Scotland. In addition, we have charged £12,500 + VAT and £2,000 + VAT respectively for the separate audit of the two subsidiaries, Historic Environment Scotland Enterprise Ltd and Scran Ltd.

No non-audit services fees have been charged by Deloitte in the period.

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## Non-audit services

In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the company's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

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## Relationships

We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence.

We are not aware of any relationships which are required to be disclosed.

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# Events and publications

## Our publications and insights to support the Board

### Publications

#### **The State of the State 2017-18**

Citizens, government and business

This year's report finds the UK government amid the complex challenge of leaving the EU. Inevitably, this early phase of EU exit is taking place under intense media scrutiny and passionate political debate. But while EU exit issues may dominate headlines, the public services face more local challenges as they address rising demand, budget restraint and renewed levels of concern about social inequality.

The State of the State 2017-18 explores government through three lenses – the citizen lens, the public sector lens and the business lens.

Download a copy of our publication here:

<https://www2.deloitte.com/uk/en/pages/public-sector/articles/state-of-the-state.html>



#### **Sharing our informed perspective**

We believe we have a duty to share our perspectives and insights with our stakeholders and other interested parties including policymakers, business leaders, regulators and investors. These are informed through our daily engagement with companies large and small, across all industries and in the private and public sectors.

Recent publications relevant to the local authorities are shared opposite:

#### **Challenges and uncertainties**

##### **Surveying trustees' annual reports in the charity sector**

This past year has been one of change as charities tackled the introduction of FRS 102 and a new Statement of Recommended Practice (SORP). Charities have been challenged to provide a clear vision with balanced reporting of achievements, successes and lessons learned.

This is our first survey under the new SORP and we look at the transition and compliance with the new SORP across a range of areas, focussing on the trustees' annual report, but sometimes considering the information provided in the statement of financial activities (SOFA), balance sheet and notes to check the consistency of presentation and information throughout the trustees' reporting.

<https://www2.deloitte.com/uk/en/pages/charities-and-not-for-profit/articles/surveying-trustees-annual-reports-in-the-charity-sector0.html>

#### **Article: Public sector transformation**

##### **Five lessons from the private sector**

An analysis of private sector global companies, including high-tech start-ups, manufacturers, banks, retailers and insurance firms, reveal five valuable lessons for the public sector.

Read the full article here:

<https://www2.deloitte.com/uk/en/pages/public-sector/articles/public-sector-transformation.html>



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