

Highlands and Islands Enterprise

Management Report 2018/19



 AUDIT SCOTLAND

Prepared for Highlands and Islands Enterprise

May 2019

Audit findings

Introduction

1. This report summarises the key issues identified during our interim audit work at Highlands and Islands Enterprise (HIE). The work included testing of key controls within financial systems to gain assurance over the processes and systems used in preparing the financial statements. We will use the results to inform our approach during the 2018/19 financial statements audit.
2. Our responsibilities under the [Code of Audit Practice](#) require us to assess the system of internal control put in place by management. We seek to gain assurance that HIE:
 - has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements
 - has systems of internal control which provide an adequate means of preventing and detecting error, fraud or corruption
 - complies with established policies, procedures, laws and regulations.
3. In addition, we carried out early substantive testing on material account areas including income, expenditure and staff costs.
4. The [Code of Audit Practice](#) also requires that we undertake work on the wider dimensions which frame the wider scope of public sector audit requirements. Our interim work focussed on HIE's preparations for EU withdrawal, and governance and transparency.
5. Any weaknesses identified represent those that have come to our attention during the course of normal audit work and therefore are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to HIE.
6. The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.
7. All our outputs and any matters of public interest will be published on our website: www.audit-scotland.gov.uk.

Conclusion

8. Overall, we found that the key controls in place within HIE's main financial systems were operating satisfactorily, with the exception of controls over access to HIE's ledger system (refer [Action Plan no. 1](#)).
9. No issues arose from our interim substantive testing of expenditure. Our early substantive testing of income transactions identified some issues with cut-off (allocation between financial years) (refer [Action Plan no. 2](#)). In addition, our early substantive testing of staff costs identified an issue with the calculation of pension contributions (refer last bullet of paragraph 13).

10. In terms of our wider dimension audit work, we concluded that HIE has taken reasonable steps to prepare for the UK's withdrawal from the European Union. We identified two areas where HIE's governance and transparency arrangements could be improved (refer [Action Plan nos. 3 & 4](#)).

Main financial systems

11. During our 2018/19 interim audit we undertook the following audit work:

- walkthrough of the key controls identified for each of HIE's main financial systems (general ledger, payroll, accounts payable and accounts receivable) to assess whether the controls were operating as intended
- testing of the key controls in operation within these systems including bank and feeder system reconciliations, controls over IT access and changes to standing data and supplier bank details
- substantive testing of income, expenditure and elements of staff costs covering the first ten accounting periods of the 2018/19 financial year.

12. In accordance with *ISA 330: the auditor's response to assessed risk*, our audit judgements are based on current year testing of controls and where appropriate prior year results. Our risk based audit allows us to take a three-year cyclical approach to controls testing. This approach enables us to place reliance on previous years' audit work where controls remain unchanged and no significant weaknesses had been identified. Also, where possible we place reliance on the work of internal audit to avoid duplication of effort.

13. Three issues were identified during our interim audit of HIE's main financial systems:

- an external contractor had been given full systems administrator access to HIE's ledger system and a full audit log of activity is not available for this category of user

[Action Plan no. 1](#)

- substantive testing of income transactions identified issues with cut-off (allocation between financial years)

[Action Plan no. 2](#)

- substantive testing of payroll calculations identified an error in the pension contributions of a new start in 2018/19. We undertook additional testing of pension contributions for new starts and existing employees which confirmed that this issue was isolated to new starts in one particular month. HIE staff have contacted the software supplier who has been unable to provide an explanation for these anomalies. Pension contributions have been recalculated and additional payments made to the affected employees' pension schemes to correct the errors identified.

Wider dimensions

14. The findings from our work on HIE's preparedness for withdrawal from the European Union are set out below together with observations from our review of HIE's arrangements for governance and transparency. Work on other wider dimension areas such as financial management and sustainability, the impact of the Enterprise and Skills Review and cyber security and business continuity arrangements is ongoing and will be reported in our Annual Audit Report.

15. Our Annual Audit Plan also refers to HIE's financial interests in the Cairngorm Mountain, including the Cairngorm funicular. We are monitoring developments as part of our 2018/19 audit and will refer to financial aspects and any wider dimension audit issues in our year-end audit reporting in August 2019.

European Union (EU) withdrawal

16. The UK's decision to leave the EU represents a major constitutional change for Scotland and there is a risk that withdrawal from the EU could adversely affect HIE's business.
17. As part of our interim audit we undertook a high-level review of HIE's preparedness for EU withdrawal focusing on three key areas: people, regulations and funding.
18. HIE has undertaken a range of activities in preparation for the UK's withdrawal from the European Union. These include:
- providing regular updates for staff through the internal HR publication
 - considering the potential impact on the supply chain as a result of EU withdrawal (no significant impact is anticipated)
 - participating in the Brexit Response Steering Group (made up of representatives from the Enterprise and Skills agencies, the Scottish Government, Business Gateway and the Scottish Cities Alliance) which developed an action plan covering skills and labour market implications, trade and investment, and business resilience
 - participating in the development of a website to aid Scottish businesses plan for EU withdrawal. The website includes a 15-point checklist to be used as a self-assessment tool, together with a list of essential actions businesses must take.
19. There is still uncertainty regarding EU withdrawal and in our view HIE has taken reasonable steps to prepare for its impact.

Governance and transparency

20. Our review of HIE's website noted that there was a significant delay in uploading Board minutes during 2018/19 with minutes for meetings held in February, April, June, August and October 2018 only uploaded in April 2019. The minutes of the December 2018 meeting are not yet available on HIE's website. Risk and Assurance Committee minutes have not been published since December 2016.
21. We also noted that registers of interests have not been published for the three new Board members appointed in September 2018, and that registers of interests for the remaining eight Board members have not been updated since April 2018. HIE's Code of Conduct for members requires all Board members to report any changes in their interests within one month and all Board members and executive grade staff are prompted, in March and September of each year, to submit a refreshed register of their interests.

[Action Plan no. 3](#)

22. Our review of HIE's scheme of delegation noted that section 6 has not been updated to reflect the new requirement to notify the Scottish Government of all write-offs in excess of £0.25 million. Previously all write-offs over £0.25 million had to be approved by the Scottish Government.

[Action Plan no. 4](#)

Reliance on internal audit

- 23.** We plan to rely on Internal Audit's work on significant transactions to support our audit opinion on the financial statements. At the time of drafting this report, Internal Audit has not yet completed this work and so we will review these areas as part of our year-end financial statements audit work.

Action Plan

Issue identified	Management response	Responsible officer and target date
Main financial systems		
<p>1. Ledger access</p> <p>Our review of the ledger user access list noted that a temporary external contractor had been given full systems administrator access to the live system. A full audit log of activity is not available for this category of user and to date there has been no monitoring of their activity.</p> <p>We would expect all activity undertaken by external contractors granted access to HIE's live ledger system to be closely monitored.</p> <p>Risk: Without close monitoring, there is an increased risk that fraudulent or erroneous transactions are not detected/corrected resulting in material misstatement of the financial statements.</p> <p><i>Planned audit work: As part of our financial statements audit, we will review journal entries and key management reports including changes to suppliers' bank details for any transactions processed by external contractors.</i></p>	<p>When implementing upgrades or changes to HIE's ledger system (Unit4 Financials) it is sometimes necessary to allow contractors access to our system.</p> <p>When working on our finance system we buddy the contractor with a member of the finance team. This allows HIE to monitor the contractor's actions and obtain 'on the job' training for staff. On this occasion the contractor was working with the HIE Financial Systems Accountant.</p> <p>Unit4 Financials does not monitor all actions carried out but can provide reports which would show transactions by a user or who has changed standing data.</p> <p>Any change to bank details or any payment transactions would be picked up as part of our weekly payment run where we carry out a 100% check of payments and banking detail changes.</p> <p>The latest available version of Unit4 Financials has workflow authorisation on standing data and transactions. In addition, the software has an audit package.</p> <p>We will consider the benefits of implementing the latest version of the Financials and the audit package.</p>	<p>Head of Financial Services</p> <p>30 September 2019</p>
<p>2. Income recognition</p> <p>Our substantive testing identified two income transactions relating to prior years which had not been accrued in last year's accounts.</p> <p>Risk: Whilst neither of the transactions are material to our audit opinion, there is a risk that HIE's current procedures for ensuring transactions are accounted for in the correct financial year are not adequate.</p> <p><i>Planned audit work: As part of our financial statements audit, we will extend our cut-off testing of income and expenditure transactions to ensure that 2018/19 income is not materially misstated.</i></p>	<p>HIE year-end procedures include an instruction for all staff to ensure that they raise an invoice for any income due before the year end. HIE finance team review all invoices raised during April to identify any late invoicing. Any late invoicing is adjusted for in the annual accounts. The 2 invoices in questions were raised in May and June. We will update our procedure to include a final review of all sales invoices over £10,000 raised in May and June to capture any late invoicing. We will also raise an instruction to staff reminding them of the importance of issuing invoices for recoverable costs promptly.</p>	<p>Head of Financial Services</p> <p>30 June 2019</p>

Issue identified	Management response	Responsible officer and target date
Wider dimensions		
<p>3. Openness and transparency</p> <p>There has been a significant delay in publishing Board minutes on HIE's website, with minutes of meetings held between February and October 2018 only recently added and minutes from December 2018 not yet available.</p> <p>Minutes of Risk and Assurance Committee meetings have not been published on HIE's website since December 2016.</p> <p>Registers of interests have not been published for three new Board members appointed in September 2018 and registers of interests for the remaining eight Board members have not been updated since April 2018.</p> <p>Risk: Gaps in the information available on HIE's website affects transparency and may also affect the public's perception of HIE's commitment to openness and transparency.</p>	<p>It is accepted that there was delay in getting minutes from the HIE Board meetings published on the HIE website during 2018. This was due to a change in the Corporate Office team.</p> <p>The Executive Support team was formed and became operational at the start of 2019. During a review of the HIE website, the Head of Executive Support (who came in to post at the start of January 2019) had identified that there were no Board minutes available from October 2018 and redacted versions of the minutes for December 2018 and the recently approved February 2019 minutes will be available on the website shortly. A target has been set for future Board minutes to be published on HIE's website within 10 working days of approval of the minute.</p> <p>As part of the exercise mentioned above, it had also been identified by the Head of Executive Support that the Risk and Assurance Committee minutes had not been published on the HIE website since the December 2016 meeting. The Head of Executive Support will undertake an exercise to review the outstanding minutes for publication and publish redacted versions of the minutes for 2017 and 2018 within the next 4 weeks and ensure that the from 2019 onwards, there will be a target date for publication of future minutes to be undertaken within 10 working days of the approval of the minute.</p> <p>In relation to the Register of Interests for Board members and Leadership Team, this was identified as an early action in January 2019 and all Board members and the Leadership Team were prompted to update their registers on 23 January with a view to publishing the updated versions from 1 April 2019. Updated registers or updated details have now been received for all Board members and this information will be published shortly. This has now been diarised to be undertaken by the Executive Support team twice yearly with updated guidance to be issued to the Board.</p>	<p>Head of Executive Support 31 May 2019</p> <p>Head of Executive Support 31 July 2019</p> <p>Head of Executive Support 17 May 2019</p>

Issue identified	Management response	Responsible officer and target date
<p>4. Scheme of delegation</p> <p>Section 6 of HIE’s scheme of delegation has not been updated to reflect the new requirement to notify the Scottish Government of all write-offs in excess of £0.25 million. Previously all write-offs over £0.25 million had to be approved by the Scottish Government.</p> <p>Risk: The scheme of delegation should be updated to reflect the updated arrangements for notifying the Scottish Government when balances in excess of £0.25 million have been written off.</p>	<p>The Business Improvement and Internal Audit (BIIA) team are currently liaising with HIE management on a wholesale review of the delegated authorities which would also address this point.</p>	<p>Compliance and Risk Manager 31 July 2019</p>

Source: Audit Scotland

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