Historic Environment Scotland

Planning report to the Audit , Risk and Assurance Committee on the 2020/21 audit Issued on 6 January 2021 for the meeting on 13 January 2021

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Planning report

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 Annual Report and Accounts.
- 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 planning report to the Audit, Risk and Assurance Committee of Historic Environment Scotland (HES) for the 2020/21 audit. This report does not cover the Historic Environment Scotland Enterprises Limited (HESe) statutory audit due to ongoing auditor appointment discussions.

I would like to draw your attention to the key messages of this paper:

Audit plan

We have updated our understanding of HES, including discussion with management and review of relevant documents. This has included consideration of the impact the COVID-19 pandemic has had on HES. Based on these procedures, we have developed this plan in collaboration with HES to ensure that we provide an effective audit service that meets your expectation and focuses on the most significant areas of importance and risk to HES.

Key risks

We have taken an initial view as to the significant audit risks HES faces. These are presented as a summary dashboard on page 12.

Audit dimensions

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland.

In carrying out our annual risk assessment, we have considered the arrangements in place for each dimension, building on our findings and conclusions from previous years' audits as well as planning guidance published by Audit Scotland. Our significant risks are presented on pages 26 to 28.

As part of our work on the audit dimensions, we will consider the arrangements in place to secure Best Value (BV) as well as other wider scope requirements set out on pages 26 to 28.

Introduction (continued)

The key messages in this report (continued)

Regulatory change

Our audit approach reflects changes to International Standards on Auditing (UK) on going concern (ISA (UK) 570) and management estimates (ISA (UK) 540), and Practice Note 10, effective for this year.

Our commitment to quality

We are committed to providing the highest quality audit, with input from our market leading specialists, sophisticated data analytics and our wealth of experience.

As part of our planning discussions with management, we have shared our "*Key Lessons from 2019/2020 Audits*" to help prepare for the 2020/21 audit, ensuring a focus on quality.

Added value

Our aim is to add value to HES through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help HES promote improved standards of governance, better management and decision making and more effective use of resources.

We have also shared our recent research, informed perspectives and best practice from our work across the wider public sector on pages 31 to 36 of this paper.

Pat Kenny
Audit Director

Responsibilities of the Audit, Risk and Assurance Committee

Helping you fulfil your responsibilities

Why do we interact with the Audit, Risk and Assurance Committee?

As a result of regulatory change in recent years, the role of the Audit, Risk and Assurance Committee has significantly expanded. We set out here a summary of the core areas of Audit, Risk and Assurance Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit, Risk and Assurance Committee in fulfilling its remit.

To communicate audit scope

To provide timely and relevant observations

To provide additional information to help you fulfil your broader responsibilities

We use this symbol to highlight areas of our audit where the Audit, Risk and Assurance Committee needs to focus attention.

Oversight of external audit

- At the start of each annual audit cycle, ensure that the scope of the external audit is appropriate.

- Implement a policy on the engagement of the external auditor to supply non-audit services.

Integrity of reporting

- Impact assessment of key judgements and level of management challenge.

- Review of external audit findings, key judgements, level of misstatements.

- Assess the quality of the internal team, their incentives and the need for supplementary skillsets.

- Assess the completeness of disclosures, including consistency with disclosures on business model and strategy and, where requested by the Board, provide advice in respect of the fair, balanced and understandable statement.

Internal controls and risks

- Review the internal control and risk management systems (unless expressly addressed by separate risk committee).

- Explain what actions have been, or are being taken to remedy any significant failings or weaknesses.

Oversight of internal audit

- Consider annually whether the scope of the internal audit programme is adequate.

- Monitor and review the effectiveness of the internal audit activities.

Whistle-blowing and fraud

- Ensure that appropriate arrangements are in place for the proportionate and independent investigation of any concerns raised by staff in connection with improprieties.

Your control environment

What we consider when we plan the audit

We expect management and those charged with governance to recognise the importance of a strong control environment and take proactive steps to deal with deficiencies identified on a timely basis.

Responsibilities of management

Auditing standards require us to only accept or continue with an audit engagement when the preconditions for an audit are present. These preconditions include obtaining the agreement of management and those charged with governance that they acknowledge and understand their responsibilities for, amongst other things, internal control as is necessary to enable the preparation of Annual Report and Accounts that are free from material misstatement, whether due to fraud or error.

Responsibilities of the Audit, Risk and Assurance Committee

As explained further in the Responsibilities of the Audit, Risk and Assurance Committee slide on the previous page, the Audit, Risk and Assurance Committee is responsible for:

- Reviewing the internal control and risk management systems (unless expressly addressed by separate risk committee).
- Explaining what actions have been, or are being taken to remedy any significant failings or weaknesses.

As stakeholders tell us that they to wish to understand how external audit challenges and responds to the quality of an entity's control environment, we are seeking to enhance how we plan and report on the results of the audit in response. We will be placing increased focus on how the control environment impacts the audit, from our initial risk assessment, to our testing approach and how we report on misstatements and control deficiencies.

Reliance on controls	We will seek to undertake design and implementation testing on controls in respect of our identified significant risk areas. In accordance with forthcoming revisions to ISAs, we will assess inherent risk and control risk associated with accounting estimates.
Performance materiality	We set performance materiality as a percentage of materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed materiality. We determine performance materiality, with reference to factors such as the quality of the control environment and the historical error rate. Where we are unable to rely on controls, we may use a lower level of performance materiality.

Our audit explained

We tailor our audit to your business and your strategy

Identify changes in your business and environment

HES continues to face significant financial pressures, which have increased during 2020/21 due to the COVID-19 pandemic. This is considered further on page 27-28.

Scoping

Our scope is in line with the Code of Audit Practice issued by Audit Scotland.

More detail is given on page 11.

In our final report

In our final report to you we will conclude on the significant risks identified in this paper, report to you our other findings, and detail those items we will be including in our audit report, including key audit matters if applicable.

Determine materiality

We will use a Group materiality level of £1,629k (2019/20: £2,111k) in planning our audit. This is based on forecast gross expenditure. We will report to you any misstatements above £81k (2019/20: £103k).

Further details on our materiality considerations are provided on page 10.

Significant risk assessment

We have identified significant audit risks in relation to HES. More detail is given on pages 12 to 14. These are different to previous years as we have reassessed the risk profile of the organisation and identified alternative risks as a result of the use of government assistance programmes.

Quality and Independence

We confirm all Deloitte network firms and engagement team members are independent of HES and the Group. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Continuous communication and reporting

Planned timing of the audit

As the audit plan is executed throughout the year, the results will be analysed continuously and conclusions (preliminary and otherwise) will be drawn. The following sets out the expected timing of our reporting to and communication with you.

Planning	Interim	Year end fieldwork	Reporting
• Planning meetings • Discussion of the scope of the audit • Discussion of audit fees • Discussion of fraud risk assessment • Update our understanding of key business cycles	• Carry out detailed risk assessments • Review of Board and Audit, Risk and Assurance Committee papers and minutes • Complete wider scope procedures	• Audit of Annual Report and Accounts, including Annual Governance Statement • Year-end audit field work • Year-end closing meetings	• Reporting of control deficiencies • Final Audit, Risk and Assurance Committee meeting • Issue final Annual Report to the Board and the Auditor General for Scotland • Submission of audited Annual Report and Accounts to Audit Scotland • Audit feedback meeting
2020/21 Audit Plan	Final report to the Audit, Risk and Assurance Committee		
November 2020 - January 2021	**March 2021**	**May – June 2021**	**August 2021**

Ongoing communication and feedback

Materiality

Our approach to materiality

Basis of our materiality benchmark

- The Audit Director has determined materiality for the Group as £1,629k (2019/20: £2,064k) and performance materiality as £1,140k (2019/20: £1,548k) , based on professional judgement, the requirement of auditing standards and the financial measures most relevant to users of the Annual Report and Accounts.
- We have used 1.8% of forecast gross expenditure as the benchmark for determining materiality and applied 70% as performance materiality. We have judged expenditure to be the most relevant measure for the users of the accounts.
- The approach is consistent with previous years, however, the percentages applied have been revisited. This takes into account our knowledge of HES and our understanding of the control environment, including increased fraud risks as a result of the pandemic.
- For the audit of HES, a materiality of £1,495k (2019/20: £1,836k) and performance materiality of £1,046k (2019/20: £1,377k) have been determined.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £81k (HES only: £74k). In 2019/20, this threshold was £103k (HES only: £91k).
- We will report to you misstatements below this threshold if we consider them to be material by nature.
- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to the Committee must not exceed £250k.

Our annual audit report

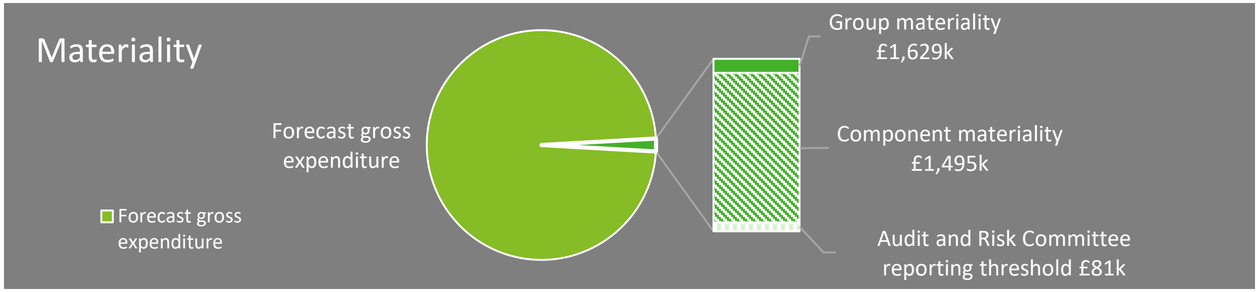
We will:

- Report group materiality, HES only materiality and the range we use for component materiality;
- Provide comparative data and explain any changes in materiality compared to prior year;
- Explain any normalised or adjusted benchmarks we use; and
- Explain the concept of performance materiality and state what percentage of materiality we used, with our rationale.

Group scoping

HES is the only significant component within the Group. HESe is an non-significant component and therefore group procedures will be performed based on group materiality which include:

- Inventory testing including stock count attendance;
- Revenue testing;
- Administrative expense testing.; and
- Desktop review of other balances.



Although materiality is the judgement of the Audit Director, the Audit, Risk and Assurance Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

Scope of work and approach

Our key areas of responsibility under the Code of Audit Practice

Core audit work	Planned output	Timeline
1. Auditing the Annual Report and Accounts	Annual audit plan	14 January 2021
	Independent auditor's report	19 August 2021
2. Audit dimensions	Annual audit plan	14 January 2021
	Annual audit report	19 August 2021
3. Other wider scope audit work	Fraud Returns	Quarterly (30 November 2020, 28 February 2021, 31 May 2021 and 31 August 2021)

Significant risks

Significant risk dashboard

Risk	Fraud risk	Planned approach to controls	Level of management judgement	Page no
Government assistance programmes	✓	DI	⚠	13
Management override of controls	✓	DI	⚠	14

Level of management judgement

⚠ High degree of management judgement

⚠ Some degree of management judgement

⚠ Limited management judgement

Controls approach adopted

DI Assess design & implementation

Significant risks

Government Assistance Programmes

Risk identified and key judgements

HES have utilised the job retention scheme – commonly referred to as the furlough scheme - offered by the UK government in response to the COVID-19 pandemic.

Due to the rapid development of the schemes and regular short-notice changes to scheme criteria, applicability and operations, there is a heightened risk of fraud within these schemes.

Given the heightened risk highlighted above, in addition to the material nature of the amounts received (£4.1m to 30 September 2020), the complexities involved in the schemes and the potential penalties for any non-compliance with scheme requirements, we have identified this as a significant audit risk, pinpointed to the occurrence of furlough income (i.e. the validity of claims made), and the completeness of any associated clawback provision.

Deloitte response and challenge

In considering the fraud risk of occurrence of furlough income, we plan to perform the following audit procedures that directly address this risk:

- Complete design and implementation procedures on the controls over the furlough income process;
- Test a sample of the monthly claims submitted and amounts received from HMRC throughout the year;
- Select a sample of employees from the claims submitted and review the validity of the claim;
- Select a sample of employees from the payroll and cross check to the claims submitted; and
- Review the disclosures presented in the Annual Report and Accounts ensuring the income is clearly presented and in line with SORP/FRS 102.

Significant risks (continued)

Management override of controls

Risk identified

Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent Annual Report and Accounts by overriding controls that otherwise appear to be operating effectively.

Although management is responsible for safeguarding the assets of the entity, we planned our audit so that we had a reasonable expectation of detecting material misstatements to the Annual Report and Accounts and accounting records.

Deloitte response and challenge

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the Annual Report and Accounts. In designing and performing audit procedures for such tests, we plan to:

- Test the design and implementation of controls over journal entry processing;
- Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- Select journal entries and other adjustments made at the end of a reporting period; and
- Consider the need to test journal entries and other adjustments throughout the period.

Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, we plan to:

- Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the Annual Report and Accounts, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, we will re-evaluate the accounting estimates taken as a whole; and
- Perform a retrospective review of management judgements and assumptions related to significant accounting estimates reflected in the Annual Report and Accounts of the prior year.

For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given our understanding of the entity and its environment and other information obtained during the audit, we shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.

Other areas of focus

Implementation of the CMIS system

Risk identified and key judgements

In October 2020 HES implemented phase one of a new integrated system – 'Corporate Management Information System (CMIS)'. This is a significant project and there is a risk that the data transferred from Integra to the new system is incomplete or that it has been transferred in a way that does not enable accurate recording of transactions throughout the year.

The risk has been pinpointed to completeness and accuracy of the data transfer. Given the ongoing involvement of the internal audit team, the project governance in place including reporting to the Board and the Scottish Government Gateway reviews, we do not consider this to be a significant audit risk. However, given the significance to the financial reporting, it will be an area of audit focus.

Deloitte response and challenge

In considering the risk of the implementation of the CMIS system, we plan to perform the following audit procedures that directly address this risk:

- Utilise IT specialists to update our understanding of controls surrounding HES's information systems – particularly CMIS;
- Gain an understanding of the implementation process and the controls in place relating to the data transfer;
- Review the reconciliation from the 2019/20 closing trial balance to the closing Integra trial balance at 30 September 2020;
- Review the reconciliation of the closing Integra trial balance to the opening CMIS trial balance using management's account mapping documentation; and
- Assess the completeness of transactions through our journal entry testing reconciliations.

Other areas of focus (continued)

Inventory

Risk identified and key judgements

ISA 501 requires auditors to perform inventory count procedures (including attendance at the inventory count) over the inventory balance. In 2019/20, we were unable to complete these procedures due to government restrictions. This resulted in a limitation of scope in our 2019/20 audit opinion.

The risk in relation to inventory is pinpointed to the existence and condition of inventory given restrictions have meant that HES has been unable to complete its normal counting process. Given the stock controls in place during the closure period and that the gross value of the movement of stock between the stock count date and year-end is expected to be below materiality, we do not consider this a significant risk.

However, given the significance of the balance to the consolidated figures we will treat it as an other area of audit focus.

Deloitte response and challenge

In considering the risk in relation to inventory existence and condition, we plan to perform the following procedures that directly address this risk:

- Understand the Inventory processes in place;
- Inventory count attendance;
- Rollback/roll-forward procedures from the stock count date to year-end (as necessary);
- Review of the inventory obsolescence provision; and
- Sample testing to ensure inventory is held at the appropriate value (the lower of cost and net realisable value).

We will consider the results of the above procedures when determining whether a modified opinion (limitation of scope in the prior year) is required for inventory.

Coronavirus (COVID-19) outbreak

Impact on our audit

Requirements	The COVID-19 pandemic had a significant impact on the 2019/20 audit process, despite impacting relatively late in the year. We would expect there to be guidance as we approach year-end on accounting and disclosure requirements for 2020/21, where the impact has been much more extensive on all organisations. A key element of this will be communicating risks and governance impacts in narrative reporting, consistent with the Financial Reporting Council's guidance to organisations on the importance of communicating the impact of COVID-19 and related uncertainties, including their impact on resilience and going concern assessments. Entity-specific explanations of the current and expected effects of COVID-19 and HES's plans to mitigate those effects should be included in the narrative reporting (including where relevant the Annual Governance Statement), including in the discussion on Principal Risks and Uncertainties impacting an organisation.
Actions	While there may be greater clarity as we approach year-end, we would expect organisations as part of their reporting to conduct a thorough assessment of the current and potential future effects of the COVID-19 pandemic including: • Consideration of the impact across HES's operations, including on its income streams, supply chains and cost base, and the consequent impacts on financial position; • The scenarios assumed in making forecasts and on the sensitivities arising should other potential scenarios materialise (including different funding scenarios); and • The effect of events after the reporting date, including the nature of non-adjusting events and an estimate of their financial effect, where possible.

Coronavirus (COVID-19) outbreak (continued)

Impact on our audit (continued)

Impact on HES and management actions	Impact on Annual Report and Accounts	Impact on our audit
We will consider the key impacts on HES such as: • Interruptions to service provision • Supply chain disruptions • Unavailability of personnel • Reductions in income	We will consider the impact of the outbreak on the Annual Report and Accounts, discussed further on the next slide including: • Narrative reporting, including disclosures on financial sustainability • Principal risk disclosures • Impact on property, plant and equipment valuations • Impairment of non-current assets • Events after the reporting period and relevant disclosures	We will continue to assess the impact on the audit including: • Resource planning • Timetable of the audit • Impact on our risk assessment • Logistics, including meetings with entity personnel

Impact on Annual Report and Accounts	
Impact on property, plant and equipment	The Royal Institute of Chartered Surveyors issued a practice alert, as a result of which valuers identified a material valuation uncertainty at 31 March 2020 for most types of property valuation. This practice alert was withdrawn in September 2020. Valuation reports at March 2020 typically identified a need to consider potential impairments in future periods, and this year's valuations may reflect more significant movements. HES will need to consider the approach to its valuation (including any changes as a result of the pandemic and consequent service and organisational changes on the "modern equivalent asset" assumed in valuations). HES will also need to consider whether there are any indications of impairment of assets requiring adjustment at 31 March 2021.

Coronavirus (COVID-19) outbreak (continued)

Impact on our audit (continued)

	Impact on Annual Report and Accounts
Narrative and other reporting issues	The following areas will need to be considered by HES: • Narrative reporting as well as the usual reporting requirements will need to cover the effects of the pandemic on services, operations, performance, strategic direction, resources and financial sustainability. • Reporting judgements and estimation uncertainty, HES will need to report the impact on material transactions including decisions made on the measurements of assets and liabilities.
Going concern assessment	The Annual Report and Accounts should include disclosure on the basis of HES's going concern assessment, including related uncertainties. HES also needs to report on the impact of financial pressures and its financial sustainability in the narrative report.
Events after the reporting period and relevant disclosures	Events are likely to continue to move swiftly, and HES will need to consider the events after the reporting period and whether these events will be adjusting or non-adjusting and make decisions on a transaction by transaction basis.

Reporting hot topics

Increased focus on quality reporting

Deloitte view

The expectations of corporate reporting, reflected in the Financial Reporting Council's (FRC) monitoring and enforcement priorities, are increasing. While the focus is primarily on corporates, we highlight these areas where improved disclosures would help meet stakeholder expectations.

The potential impacts of Brexit

Depending upon events, organisations may be preparing the Annual Report and Accounts against the backdrop of continued uncertainty around the UK's future relationship with the EU. Even with a deal, the future basis of UK-EU trade will affect the longer-term viability period of 3-5 years and a longer consideration of prospects.

ACTION: Depending upon events through to the date of signing, we would expect to see Annual Reports reflecting at least:

- relevant risks and uncertainties, and actions taken to manage those risks; and
- consideration whether there is any impact on critical accounting judgements and areas of estimation uncertainty.

We will discuss with HES closer to the time areas where disclosures may be appropriate.

Climate-related risks

The report by the Intergovernmental Panel on Climate Change (IPCC) has made it clear that prompt and decisive action on climate change is required from governments, businesses and individuals alike.

The recommendations of the Taskforce on Climate-related Financial Disclosure (TCFD) are gaining momentum. The government has proposed mandatory TCFD disclosures by 2022, and the FRC is undertaking a major review of how organisations assess and report the impact of climate change. The FRC expects organisations to disclose how they have taken climate change into account in assessing the resilience of the business model, its risks, uncertainties and viability both in immediate and longer term.

Investors are challenging companies that are not factoring the effects of the Paris Climate Agreement into their critical accounting judgements and are not disclosing comprehensively these judgements, assumptions, sensitivities and uncertainties.

ACTION: Clearly articulate how your organisation is addressing climate change e.g.

- whether this is a principal risk and how it is being managed; and
- its impact on the business model, the viability statement and the key assumptions and projections in impairment reviews and valuations (including in assessing remaining asset lives).

Revisions to auditing standards coming into effect

ISA (UK) 570 – Going concern

The FRC issued a revised going concern standard in September 2019, that takes effect for periods commencing on or after 15 December 2019. For public sector bodies, this will be March 2021 year ends and later.

The revision was made in response to recent enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after.

We have summarised below the key areas of change in the standard – however, the Public Audit Forum is also consulting on changes to Practice Note 10, with the intention of reflecting public sector considerations in the approach to going concern, and so the ultimate impact of ISA (UK) 570 changes will be affected by this.

The key changes affect:

- Risk assessment procedures and related activities, increasing consideration of the entity's business model, operations and financing;
- The auditor's evaluation of management's assessment of the going concern assumption (which therefore requires a clearly documented assessment to be prepared by management);
- Enhanced professional scepticism requirements, including around the evaluation of the sufficiency and appropriateness of audit evidence;
- Considering the appropriateness of disclosures; and
- Reporting in enhanced audit reports.

"The revised standard means UK auditors will follow significantly stronger requirements than those required by current international standards."

FRC's press release, 30 September 2019

Revisions to auditing standards coming into effect (continued)

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures

Since 2015, the International Auditing and Assurance Standards Board (IAASB) has sought to identify audit issues relating to accounting estimates for financial institutions and other entities. Initially, this focused on the impact of IFRS 9 *Financial Instruments*, because it would fundamentally change the way that banks and other entities account for loan assets and other credit exposures.

However, the IAASB concluded that most, if not all, issues identified for expected credit losses would be equally relevant when auditing other complex accounting estimates. Accordingly, a holistic revision of ISA 540 was undertaken and the new standard takes effect for periods commencing on or after 1 January 2020. For public sector bodies, this will be March 2021 year ends and later.

We summarise on the next few slides how this will impact our audit.

"There is a clear need to update ISA 540 to support better quality audits of increasingly complex accounting estimates."

FRC letter to the IAASB, July 2017

Area of change	Impact on our audit	Impact on HES
Assessment of oversight and governance relating to estimates	In connection with our planning work to understand the entity and its environment, including internal control, we will specifically enquire regarding management's processes, and the oversight and governance of those processes relating to accounting estimates.	You will need to consider the adequacy of your processes and controls over estimates, and documentation thereof.

Revisions to auditing standards coming into effect (continued)

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures (continued)

Area of change	Impact on our audit	Impact on HES
Identification of inherent risk factors; separate assessment of inherent risk and control risk Objectives-based work effort requirements	Recognising a spectrum of inherent risk, we will assess risks of material misstatement in estimates with reference not only to estimation uncertainty, but also complexity, subjectivity or other inherent risk factors, and the interrelationship among them. We will specifically assess control risk relating to estimates, which may require us to evaluate the design and determine implementation of an increased number of internal controls. Our subsequent audit procedures will be responsive to this assessment, and designed to obtain evidence around the methods, significant assumptions, data and (where applicable) the selection of a point estimate and related disclosures about estimation uncertainty.	You will need to provide clear documented rationale for (a) the selection and application of the method, assumptions and data in making the accounting estimate, including any changes in the current year, and controls relating to those aspects; and/or (b) the selection of a point estimate and related disclosures for inclusion in the Annual Report and Accounts.
Enhanced "stand back" requirement, to evaluate the audit evidence obtained	We will specifically design our procedures, to enhance our application of professional scepticism, so that they are not biased towards finding corroborative evidence; our overall evaluation of the evidence obtained will weigh both corroborative and contradictory evidence.	You should expect more challenge of the evidence provided in support of accounting estimates, use of external data sources and your consideration of contradictory evidence.

Revisions to auditing standards coming into effect (continued)

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures (continued)

Area of change	Impact on our audit	Impact on HES
Enhanced requirements about whether disclosures are “reasonable”	The extant ISA 540 required us to evaluate whether disclosures were “adequate”. The change to “reasonable” will involve greater consideration of the overall meaning conveyed through disclosures. For example, where estimation uncertainty associated with an estimate is multiple times materiality, we will consider whether the disclosures appropriately convey the high degree of estimation uncertainty and the range of possible outcomes.	You should expect more challenge on disclosures relating to estimates, particularly for where you have selected a point estimate from a range and those with high estimation uncertainty.
New requirements when communicating with those charged with governance	In accordance with ISA (UK) 260 and ISA (UK) 265, our communications from the audit have included significant qualitative aspects of your accounting practices and significant deficiencies in internal control. With the revised ISA (UK) 540, these communications will specifically include matters regarding accounting estimates and take into account whether the reasons for our risk assessment relate to estimation uncertainty, or the effects of complexity, subjectivity or other inherent risk factors.	You should expect increased reporting in relation to accounting estimates which may be mirrored in our Annual Audit Report.

Areas where we consider the impact to be greatest:

Key areas impacted will include property valuations and provisions (including dilapidations and compensation claims). In 2019/20, we requested that management provide a paper setting out how they have arrived at the calculated provisions, including their assumptions, both confirmatory and contradictory evidence and how these have been considered in determining the calculation, and other information they felt to be relevant. Management also obtained a detailed report from an external expert on property valuations, to support the valuation recorded. Management should ensure that this information is available in advance of the 2020/21 audit fieldwork.

Audit Quality

Our commitment to audit quality

Our objective is to deliver a distinctive, quality audit to you. Every member of the engagement team will contribute, to achieve the highest standard of professional excellence.

In particular, for your audit, we consider that the following steps will contribute to the overall quality:

- We will apply professional scepticism on material issues and significant judgements by using our expertise in the central government sector and elsewhere to provide robust challenge to management.
- We have obtained a deep understanding of your business, its environment and of your processes in income and expenditure recognition, payroll expenditure and capital expenditure enabling us to develop a risk-focused approach tailored to HES.
- Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. We will involve IT specialists to support the audit team in our work on the new system.
- In order to deliver a quality audit to you, each member of the core audit team has received tailored learning to develop their expertise in audit skills, delivered by Pat Kenny (Audit Director) and other sector experts. This includes sector specific matters and audit methodology updates.

Engagement Quality Control Review

We have developed a tailored Engagement Quality Control approach. Our dedicated Professional Standards Review (PSR) function will provide a 'hot' review before any audit or other opinion is signed. PSR is operationally independent of the audit team, and supports our high standards of professional scepticism and audit quality by providing a rigorous independent challenge.

Wider scope requirements

Overview

The Code of Audit Practice sets out four audit dimensions that frame the wider scope of the audit of the Annual Report and Accounts. The audit dimensions provide a common framework for all the audit work conducted for the Auditor General and for the Accounts Commission.

In carrying out our annual risk assessment, we have considered the arrangements in place, building on our findings and conclusions from previous year's audits as well as planning guidance published by Audit Scotland. The following pages summarise the significant risks identified and our planned audit response.

The risk profile of public bodies for the 2020/21 audits is significantly affected by the COVID-19 pandemic. The pandemic has highlighted the importance of many long-standing issues that auditors across the public sector have previously reported on, such as the need for good governance, openness and transparency and effective longer-term planning to deliver better outcomes. The risks and challenges associated with these issues have become greater due to the pandemic. Audit Scotland's COVID-19 Guide for Audit Committees sets out the key short term risks and challenges facing public bodies (https://www.audit-scotland.gov.uk/uploads/docs/report/2020/as_200825_covid19_guide_audit_risk_comm.pdf). They are heightened further because of the uncertainty around the UK's exit from the European Union and increasing budget pressures.

In accordance with Audit Scotland planning guidance, in assessing risks in 2020/21, and in order to deliver a high quality audit, we have focussed on risks related to governance and transparency, financial sustainability, and counter-fraud arrangements.

Considering Best Value arrangements	Other areas
The Scottish Public Finance Manual (SPFM) explains that accountable officers have a specific responsibility to ensure that arrangements have been made to secure BV. We will consider these arrangements when planning and reporting on the audit dimensions, discussed on pages 27 to 28.	We are required to also carry out the following areas of work: • Preliminary enquiries on all correspondence received from regulators • Submission of fraud returns

Wider scope requirements (continued)

Audit dimensions

Audit dimension	Significant risks identified	Planned audit response
Financial sustainability	The financial impact of the pandemic includes a projected reduction in income of £53m for 2020/21. Additional funding of £37.6m has been confirmed by the Scottish Government to partly offset this. Future year funding has not yet been confirmed. While HES has historically achieved short-term financial balance and had made some progress prior to the pandemic with its updated Financial Strategy and Programme for Success, there remains a significant risk that robust long-term planning arrangements are not in place to ensure that HES can manage its finances sustainably and deliver services effectively, identify issues and challenges early and act on them promptly.	We will assess the progress being made in developing and implementing the 2020/21 action plans, including a recovery plan. We will also assess the implications for the medium-long term planning arrangements, including the financial strategy and targeted efficiency review.
Financial management	We have not identified any significant risks in relation to financial management during our planning. Since the start of the pandemic, the risk of fraud and error has increased as the control environment and internal control change. In accordance with Audit Scotland planning guidance, we will consider fraud as a particular focus area in 2020/21.	We will continue to review the financial management arrangements. Using Audit Scotland's publication "COVID-19 Emerging Fraud Risks", we will assess what action HES has taken to minimise risk to its control environment and internal controls.

Wider scope requirements (continued)

Audit dimensions (continued)

Audit dimension	Significant risks identified	Planned audit response
Governance and transparency	Following the changes made to the governance arrangements in response to the pandemic, including the establishment of a recovery group, there is a risk that revised arrangements are not appropriate or operating effectively. The Board and its Committees have continued to meet virtually since the start of the pandemic.	We will review the work of the Board and ARAC to assess whether the arrangements are operating effectively, including assessing whether there is effective scrutiny, challenge and informed decision making.
	While risk management processes continue to be in place, the likelihood and impact of existing risks and the emergence of new risks will need to be monitored carefully. There is a risk that officers and the ARAC members have not considered how sustainable any changes to the risk appetite will be in the longer term. We are aware that ARAC has considered both the COVID-19 risk register and more recently the combined risk register at its meetings.	We will review the work undertaken in relation to risk management including updates to the policies in place as a result of COVID-19 and whether these are appropriate for the long-term.
Value for money	The pandemic is expected to have had a substantial impact on performance measures, particularly for services which have been temporarily suspended, or are provided at a reduced level. The pandemic has had a significant impact on HES' operations, in particular, the operation of visitor sites as well as the conservation and research work normally undertaken. HES has implemented two 6 month action plans in place of the usual annual operating plan for 2020/21 which it has measured performance against. There is a risk that performance reporting has not been timely, reliable, balanced, transparent and appropriate to users' needs.	We will review the performance reports presented to the Board to assess performance in addition to assessing the reliability, timeliness, balance and transparency of reporting during the year.

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 establish our respective responsibilities in relation to the Annual Report and Accounts audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope; and
- Key regulatory and corporate governance updates, relevant to you.

What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to HES.

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, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the Annual Report and Accounts and the other procedures performed in fulfilling our audit plan.

Use of this report

This report has been prepared for the Audit, Risk and Assurance Committee, 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. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

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

Other relevant communications

We will update you if there are any significant changes to the audit plan.

Pat Kenny

for and on behalf of Deloitte LLP

Glasgow | 6 January 2021


Technical update

What does climate change mean for business?

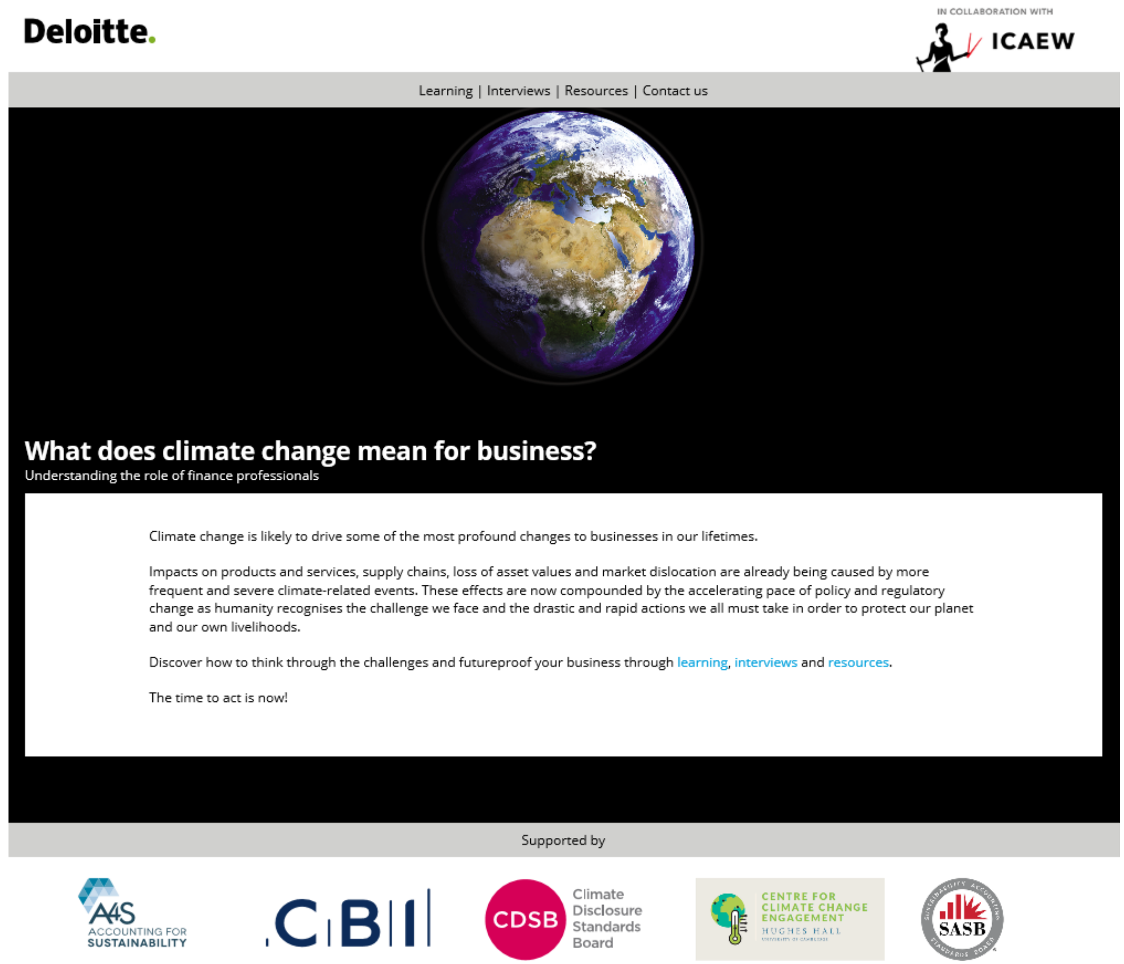
New website – learning, interviews and resources

Climate change is likely to drive some of the most profound changes to businesses in our lifetimes.

Impacts on products and services, supply chains, loss of asset values and market dislocation are already being caused by more frequent and severe climate-related events.

Discover how to think through the challenges and futureproof your business.

The time to act is now!



Visit: www.deloitte.co.uk/climatechange

OSCR Developments

Scottish Charity and Public Surveys 2020

Key findings include:

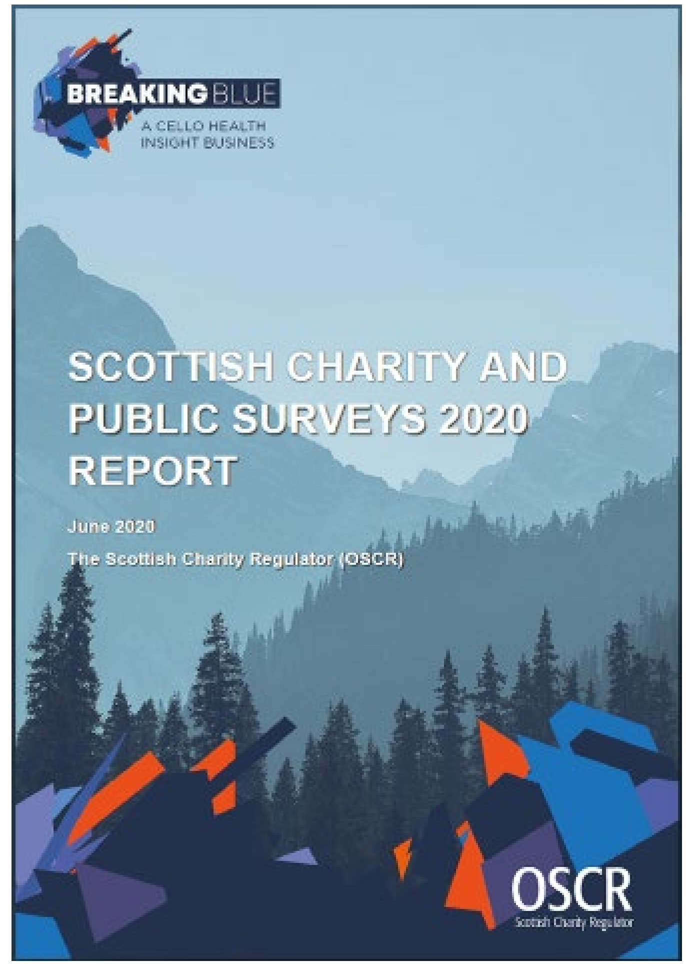
•Public trust has increased to an average score of 7.02 out of 10 in 2020 from 6.14 out of 10 in 2018. Trust was strongest for charities working in Scotland (7.2 out of 10), charities working with volunteers only (7.18 out of 10) and charities working locally (7.09 out of 10).

•93% of Scottish adults have given money, time or goods to a charity in the last year.

•The importance of a charity's cause was the most common reason for choosing to support a charity (56% of those who donate), followed by trustworthiness (44% of those who donate).

•Feedback from charities found that OSCR is highly trusted to keep a reliable register (96%) and to regulate the charity sector fairly (94%).

•58% of the public said knowing how much of a donation goes to the cause and 55% said seeing evidence of what the charity has achieved would make them feel a charity was trustworthy.



Read the report in full **[here]**

Changes to the Government Financial Reporting Manual (FReM)

2020/21 Edition

Background

HM Treasury has issued a revised version of the FReM for the financial year 2020/21. The FReM is the technical accounting guide to the preparation of financial statements and complements guidance on the handling of public funds published by the Scottish Government.

The 2020/21 edition has a revised structure and is now separated into four sections:

- Part A: Principles, purpose and best practice.
- Part B: The form and content of government Annual Reports and Accounts.
- Part C: Application of accounting standards to government Annual Reports and Accounts.
- Part D: Further guidance for government Annual Reports and Accounts.

Other changes include:

- A new chapter addressing best practice in narrative reporting.
- Clearer guidance on the performance report, including specific mandatory requirements.
- Introduction of 'comply or explain' requirements in certain areas including the structure of the organisation, risks faced, unit cost data and relevant trend data.

A full amendments log has been published which explains the changes from 2019/20 and the reason for the change: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/853244/2020-21_Amendment_Record.pdf

Next steps

We recommend that management review the changes to the FReM at the earliest opportunity. In particular the new chapter on narrative reporting best practice and the guidance on the performance report should be reviewed to understand the mandatory requirements and those which require HES to 'comply or explain'. This can then be compared with the published 2019/20 Annual Report and Accounts to identify any amendments required. We are happy to have early discussion on this to agree proposed amendments.

State of the State 2020/21

Government in the pandemic and beyond

Background and overview

Now in its ninth year, this report brings together Deloitte and Reform to reflect on new research into the issues facing government and public sector across the UK. This year, that research focuses on the impact of the coronavirus pandemic both on the public sector and the public it services. It comes as all nations of the UK faces new lockdown measures designed to reduce transmission, manage demand on health services and ultimately saving lives.

At the heart of the report is our exclusive citizen survey, which offers insight into perceptions of public services and public spending beyond COVID-19, as well as a public perspective on the government's 'levelling up' agenda.

That survey is complemented by our interviews with public sector leaders. This year, we spoke to 40 senior figures in government and public services, producing the most extensive qualitative research of its kind.

Next steps

A summary of the key conclusions are provided on the next page. The full report is available at https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/public-sector/deloitte-uk-state-of-the-state-2020.pdf

State of the State 2020/21 (continued)

Government in the pandemic and beyond (continued)

The state according to the public

A survey of more than 5,000 members of the public shows how people feel about tax, spending and public service priorities amid the COVID-19 pandemic. We also explore attitudes towards data sharing with and across government, and unpick what the public across each nation and region wants to see levelled up

58% of the public believe opportunities for young people will be worse as a result of coronavirus.

42% of the public believe that community spirit will have improved after the pandemic

The state according to the people who run it

Over 40 senior public sector figures in England, Scotland, Wales and Northern Ireland talked with us about the issues that matter to them. We explore their views on the legacy of COVID-19, levelling up, EU Exit and creating a data-driven government.

Our interviews of **40** senior public sector figures found that many want to retain the agility of new ways of working however, many sense a gravitational pull back to normality.

Fast forward to the past

Is automation making organisations less diverse?

Background and overview

Robotics and intelligent automation are in the process of transforming the nature of work and the skills required to do it. Whilst there is a clear risk of reinforcing structural inequalities there is also an opportunity to address diversity issues within automation programmes to ensure public sector organisations can capitalise on the benefits that both automation and diversity bring to business outcomes.

For many public sector organisations implementing automation whist considering diversity is new and unchartered territory. We would like to encourage our public sector clients to consider and discuss this crucial issue.

Based on exclusive client interviews, insight from public sector projects and extensive desk research, our report explores the potential risks of not considering the implications of automation on workforce diversity and inequality. It also identifies the barriers to embedding diversity in automation programmes.

The report provides a practical four stage framework to integrate diverse groups to not only survive but thrive in a new automated and digital world.

Next steps

The full report is available at https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/public-sector/deloitte-uk-diversity-and-automation-brochure-landscape.pdf

Appendices

Prior year audit adjustments

Uncorrected misstatements

The following uncorrected misstatements were identified during the course of our prior year audit:

		Credit/(Charge) to the SOFA £k	Increase/ (Decrease) in net assets £k	Increase/ (Decrease) in retained earnings £k
Factual misstatements				
Deferral of Membership Income	[1]	1,023	(1,023)	-
Total		**1,023**	**(1,023)**	**-**

(1) As noted in our 2019/20 Annual Audit Report, we identified a misstatement due to HES's accounting policy for deferral of membership income. This was accounted for under a cash basis rather than the accruals basis. While the adjustment was not material the total value of membership income was material and therefore an audit adjustment was recorded, which management decided not to correct for. Management accepted the basis for the adjustment and will put in place arrangements to correct this in 2020/21.

We obtained written representations from the Board of Trustees confirming that after considering this uncorrected item, in the context of the consolidated Annual Report and Accounts taken as a whole, no adjustments were required.

Our other responsibilities explained

Fraud responsibilities

Your 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.

Our responsibilities:

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the Annual Report and Accounts as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified risks of material misstatement due to fraud in relation to government assistance programmes, and management override of controls.
- We will explain in our audit report how we considered the audit capable of detecting irregularities, including fraud. In doing so, we will describe the procedures we performed in understanding the legal and regulatory framework and assessing compliance with relevant laws and regulations.

Whilst this requirement has been in place for a few years for public interest entities (as defined by the EU Audit Regulation), recent changes to ISAs (UK) mean it will apply to **all** entities for periods **commencing on or after 15 December 2019.**

Fraud Characteristics:

- Misstatements in the Annual Report and Accounts can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the Annual Report and Accounts is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

Our other responsibilities explained (continued)

Fraud responsibilities (continued)

We will make the following inquiries regarding fraud and non-compliance with laws and regulations:

Management:

- Management's assessment of the risk that the Annual Report and Accounts may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to risks of fraud.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.
- We have involved management from outside the finance function in our inquiries, in particular the CEO.

Internal audit

- Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.

Those charged with governance

- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.

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:

Independence confirmation	We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of HES and will reconfirm our independence and objectivity to the Audit, Risk and Assurance Committee for the year ending 31 March 2021 in our final report to the Audit, Risk and Assurance Committee.
Fees	The fee range for the 2020/21 audit will be provided by Audit Scotland in January 2021 will be discussed and agreed with management and the Audit, Risk and Assurance Committee in early 2021. There are no non-audit services fees proposed for the period.
Non-audit services	In our opinion there are no inconsistencies between the FRC's Ethical Standard 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.
Relationships	We have no other relationships with HES, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Our approach to quality
AQR team report and findings

Audit quality remains our number one priority and we have a relentless commitment to it. We continue to invest in and enhance our Audit Quality Monitoring and Measuring programme.

In July 2020 the Financial Reporting Council ("FRC") issued individual reports on each of the seven largest firms, including Deloitte, on Audit Quality Inspections providing a summary of the findings of its Audit Quality Review ("AQR") team for the 2019/20 cycle of reviews.

We greatly value the FRC reviews of our audit engagements and firm wide quality control systems, a key aspect of evaluating our audit quality.

We are pleased with our results for the inspections of FTSE 350 entities achieving 90% assessed as good or needing limited improvement, which included some of our highest risk audits. Our objective is for 100% of our audits to be assessed as good or needing limited improvement and we know we still have work to do in order to meet this standard. We are however, extremely disappointed one engagement received a rating of significant improvements required during the period. This is viewed very seriously within Deloitte and we have worked with the AQR to agree a comprehensive set of swift and significant firm wide actions.

We are also pleased to see the impact of our previous actions on prior year adjustments is reflected in the results of current year inspections with no findings in this area. In addition the FRC identified good practice examples including in: risk assessment, group oversight, our comprehensive IFRS 9 expected credit loss audit programme and our Audit Committee reporting.

Embedding a culture of challenge in our audit practice underpins the key pillars of our audit strategy. We invest continually in our firm wide processes and controls, which we seek to develop globally, to underpin consistency in delivering high quality audits whilst ensuring engagement teams exercise professional scepticism through robust challenge.

All the AQR public reports are available on its website. https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports

Our approach to quality (continued)

AQR team report and findings (continued)

The AQR's 2019/20 Audit Quality Inspection Report on Deloitte LLP

"We reviewed 17 individual audits this year and assessed 13 (76%) as requiring no more than limited improvements. Of the ten FTSE 350 audits we reviewed this year, we assessed nine (90%) as achieving this standard."

"We have highlighted in this report aspects of firm-wide procedures which should be improved, including strengthening the monitoring of the firm's audit quality initiatives."

"Our key findings related principally to the need to:

- Improve the extent of challenge over cash flow forecasts in relation to the impairment of goodwill and other assets.
- Enhance the effectiveness of substantive analytical review and other testing for revenue.
- Improve the assessment and extent of challenge regarding management's estimates, particularly for model testing."

"The firm has taken steps to address the key findings in our 2019 public reports, with actions that included focused training and standardising the firm's audit work programs. We have identified improvements, for example in the audit of potential prior year adjustments and related disclosures, a key finding last year. We also identified good practice in a number of areas of the audits we reviewed (including effective group oversight and robust risk assessment) and in the firm-wide procedures (including the firm's milestone program, with expected dates for the phasing of the audit monitored by the firm)."

Deloitte.