



Historic Environment Scotland

Planning report to the Audit, Risk and Assurance Committee on the 2021/22 audit

Issued on 18 January for the meeting on 26 January 2022

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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 ('the Committee') of Historic Environment Scotland ("HES") for the 2021/22 audit. 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 continuing impact the COVID-19 pandemic is having 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 the HES faces. These are presented as a summary dashboard on page 11.

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 arrangement's 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 audit dimension significant risks are presented on pages 12 to 13.

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 20 to 24.

Introduction (continued)

The key messages in this report (continued)

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.

Managing transition to 2022/23 audits

2021/22 is the final year of the current audit appointments. We will minimise disruption to all parties, and maximise the transfer of knowledge of HES, by working in partnership with Audit Scotland and the incoming auditors.

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.

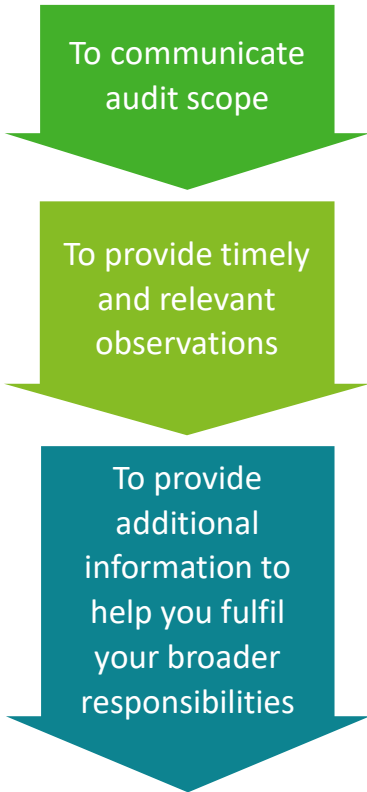
We have also shared our recent research, informed perspectives and best practice from our work across the wider public sector on pages 26 to 30 of this plan.

Pat Kenny
Audit Director

Responsibilities of the Audit, Risk and Assurance Committee

Helping you fulfil your responsibilities

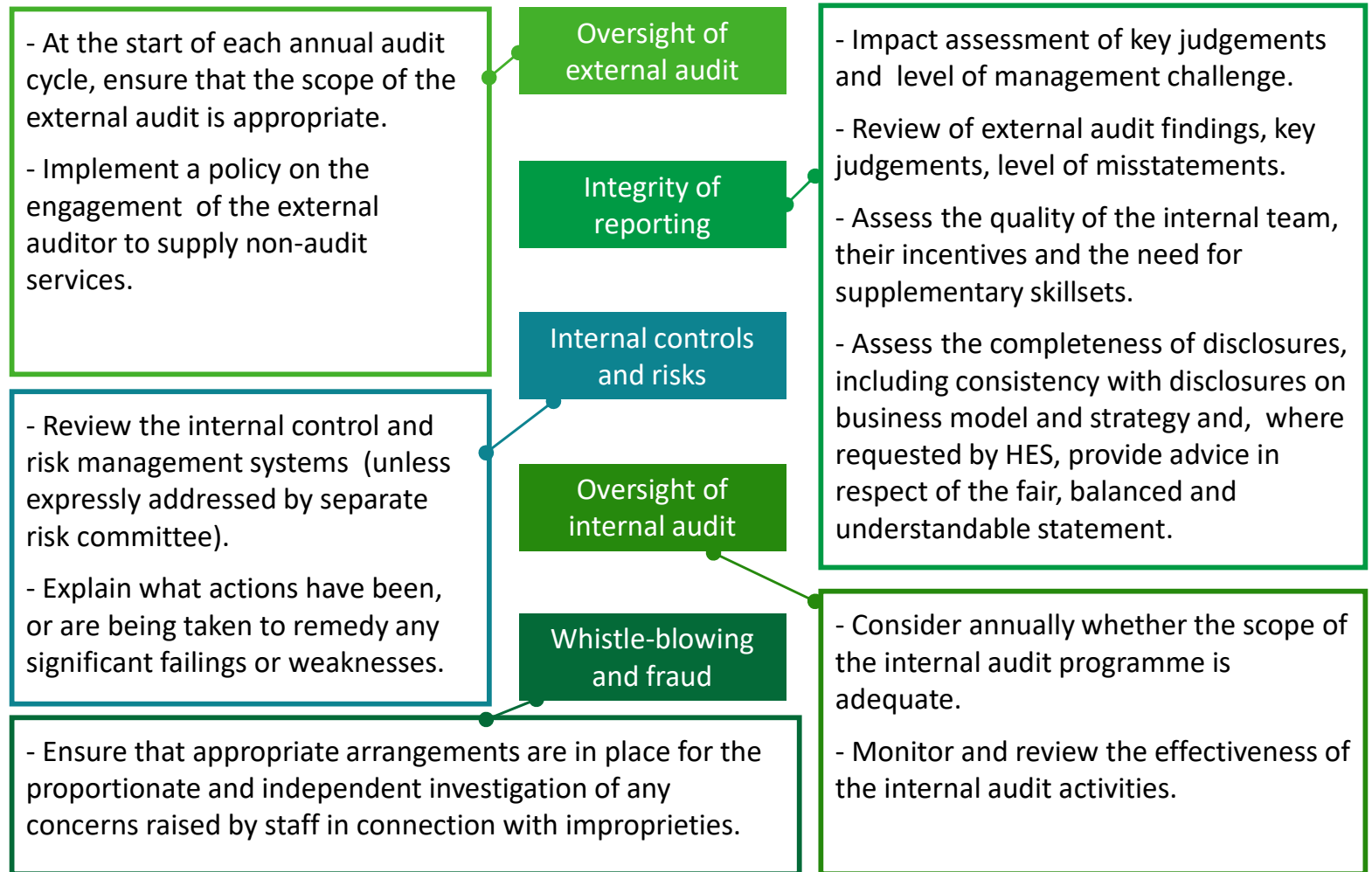
Why do we interact with the Audit, Risk and Assurance Committee?



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



As a result of regulatory change in previous 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.



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 the Annual Report and Accounts that are free from material misstatement, whether due to fraud or error.

As stakeholders tell us that they 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.

Responsibilities of the Audit, Risk and Assurance Committee

As explained further in the Responsibilities of the Audit 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 a separate risk committee).
- Explaining what actions have been, or are being taken to remedy any significant failings or weaknesses.

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.

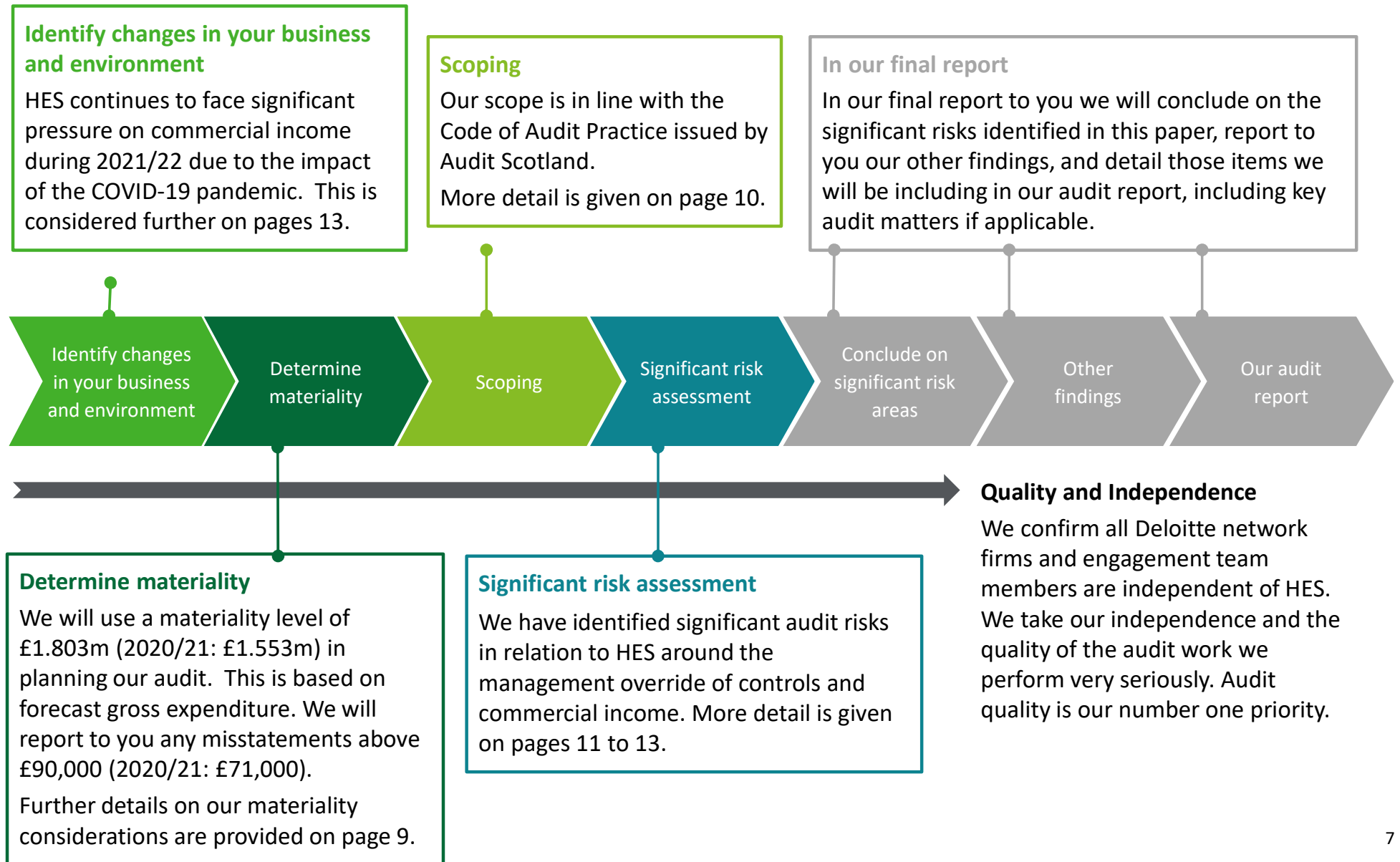
Performance materiality



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

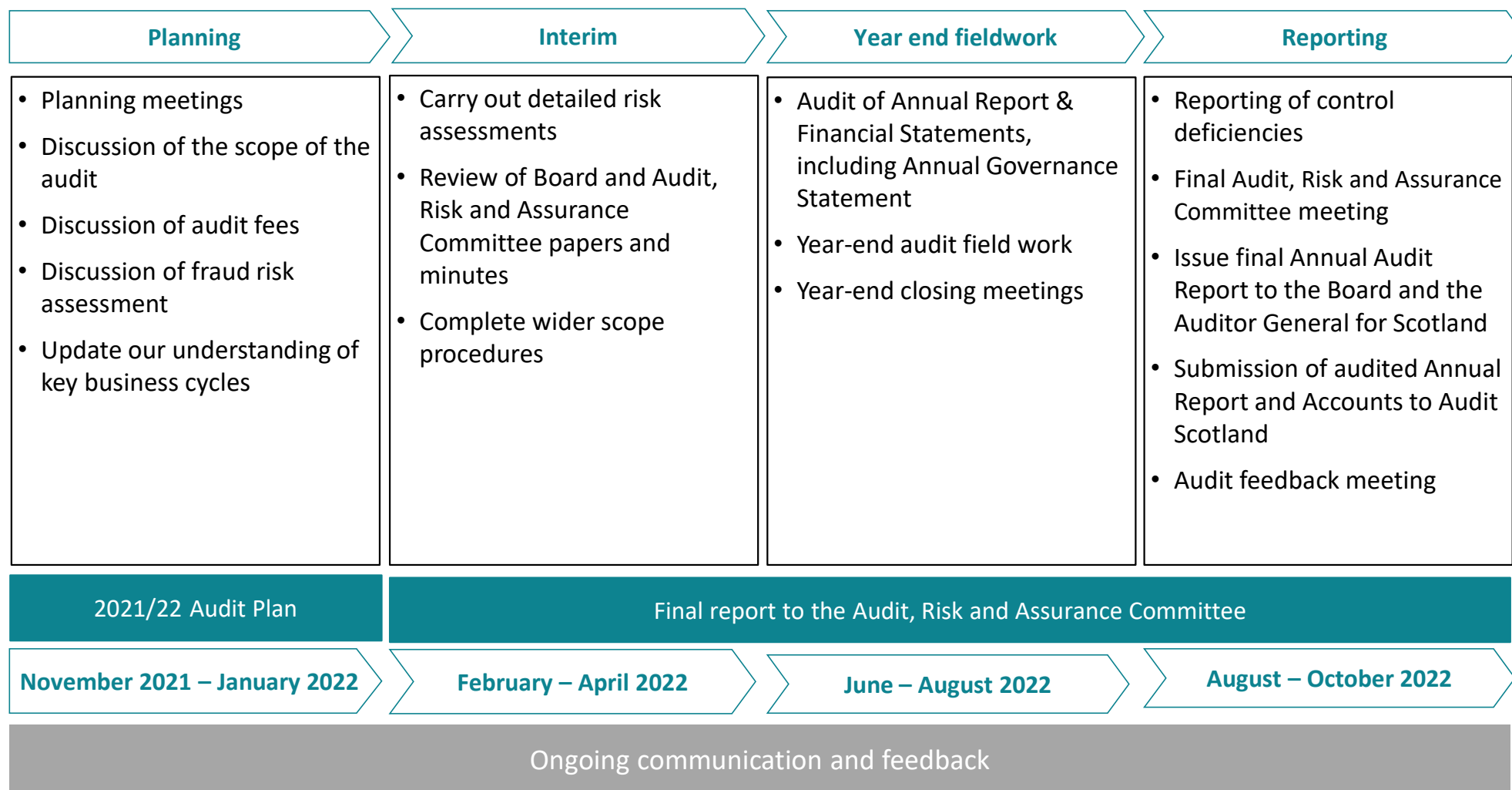
We tailor our audit to your business and your strategy



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.



Materiality

Our approach to materiality

Basis of our materiality benchmark

- The Audit Director has determined materiality for the group as £1.803m (2020/21: £1.553m) and performance materiality as £1.262m (2020/21: £1.009m), based on professional judgement, the requirements of auditing standards and the financial measures most relevant to users of the Annual Report and Accounts.
- We have used 1.8% (2020/21: 1.8%) of forecast gross expenditure as the benchmark for determining materiality and applied 70% (2020/21: 65%) as performance materiality. We have judged expenditure to be the most relevant measure for the users of the accounts.
- The percentages applied have been revisited to take 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 (Charity only), a materiality of £1.655m (2020/21: £1.428m) and performance materiality of £1.135m (2020/21: £1.009m) have been determined.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £90,000 (Charity only: £82,000).
- 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

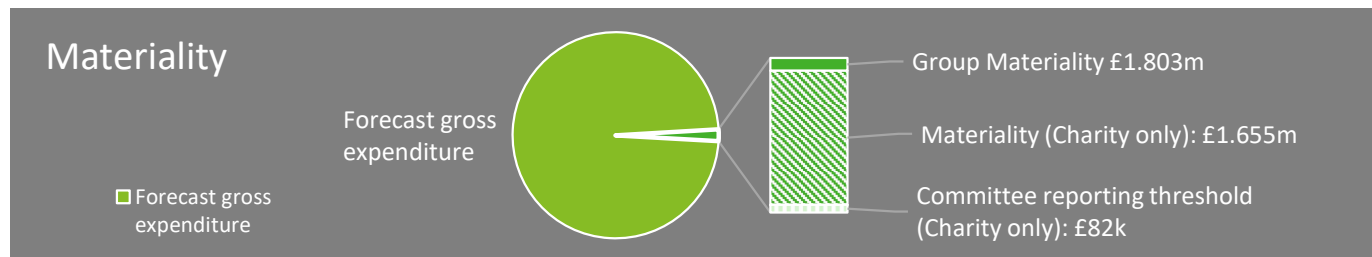
We will:

- Report group materiality, HES only materiality and the range we use for component materialities;
- 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 a 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 | Proposed reporting timeline to the Committee | Audit Scotland/ statutory deadline |
|---------------------------------|---|--|--|
| 1. Auditing the annual accounts | Annual Audit Plan | 26 January 2022 | 28 Feb 2022 |
| | Independent auditor's report | September 2022* | 31 Oct 2022 |
| 2. Audit dimensions | Annual Audit Plan | 26 January 2022 | 28 Feb 2022 |
| | Annual Audit Report | September 2022* | 31 Oct 2022 |
| 3. Other wider scope audit work | Fraud Returns | N/A | 30 Nov 2021, 28 Feb 2022, 31 May 2022, 31 Aug 2022 |
| | National Fraud Initiative (NFI) audit questionnaire | N/A | 28 February 2022 |

*Precise reporting dates to be confirmed with management.

Significant risks

Significant risk dashboard

| Risk | Fraud risk | Planned approach to controls | Level of management judgement | Page no |
|-----------------------------------|---|---|---|---------|
| Management override of controls |  |  |  | 12 |
| Completeness of commercial income |  |  |  | 13 |

Level of management judgement



High degree of management judgement



Some degree of management judgement



Limited management judgement

Controls approach adopted



Assess design & implementation

Significant risks

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.

Significant risks (continued)

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 properties in care. 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.

As regular reconciliations are performed between the bank accounts and the amounts recognised via the Galaxy till receipting system, the risk is focused on how any reconciling items are investigated and addressed. This will be our key area of audit focus.



Deloitte response and challenge

In considering the risk around completeness of commercial income, we plan to perform the following audit procedures that directly address this risk:

- obtain an understanding of the design and implementation of the key controls in place in relation to recording of commercial income;
- perform analytical procedures over commercial income reported for the year, based on visitor numbers and price changes, to confirm accuracy; and
- Detailed testing of the year-end reconciling difference as identified in the monthly control account reconciliation, being the difference between what is uploaded from the Galaxy system, and what is uploaded from the bank statements, to gain assurance over completeness of amounts recognised as income in the financial statements.

Coronavirus (COVID-19) outbreak

Impact on our audit

The COVID-19 pandemic had a significant impact on the 2019/20 and 2020/21 audit process.

Requirements

A key element of the reporting requirements for HES, which will continue for 2021/22, is 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

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 |
|--|---|--|
| <p>We will consider the key impacts on HES such as:</p> <ul style="list-style-type: none">• Interruptions to service provision• Supply chain disruptions• Unavailability of personnel• Reductions in income | <p>We will consider the impact of the outbreak on the Annual Report and Accounts, discussed further on the next slide including:</p> <ul style="list-style-type: none">• Narrative reporting, including disclosures on financial sustainability• Principal risk disclosures• Impact on property, plant and equipment valuations• Impairment of non-current assets• Allowance for expected credit losses• Events after the reporting period and relevant disclosure | <p>We will continue to assess the impact on the audit including:</p> <ul style="list-style-type: none">• 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 2022.

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 the Board'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 ('the FRC') monitoring and enforcement priorities, are increasing. While the focus is primarily on corporate entities, we highlight these areas where improved disclosures would help meet stakeholder expectations.



The ongoing uncertainty about the UK's future relationship with the EU

The UK-EU Trade and Cooperation Agreement (the 'Deal') agreed on 24 December 2020 has brought certainty and clarification about many (but importantly not all) of the changes arising from the UK's departure from the EU. HES should update their assessments of the impact of Brexit on their operations and business model, and on the Annual Report and Accounts (both the recognition and measurement of assets and liabilities and the related disclosures).

Clear disclosure should be provided of the key assumptions used in cash flow forecasts and the significant judgements and estimates made in recognising and measuring the amounts in the Annual Report and Accounts.

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

- relevant risks and uncertainties, and actions taken to manage those risks; and
- consideration of 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.

Reporting hot topics (continued)



Climate-related risks

The PRI and other investors groups have published an open letter confirming their view that climate-related risks are material factors that should be reflected appropriately in Annual Report and Accounts statements. The IIGCC has also published a report reiterating their expectations for the Paris Agreement to be considered in drawing up accounts.

In November 2020, the FRC published its review of climate-related considerations which includes the FRC's expectations of companies, financial statements and auditors. The FRC highlights that "the implications of climate change will affect a wide range of companies. In developing a company's strategic direction, boards "should be taking into account all the possible effects of climate change" and that "corporate reporting should address the company's impact on the environment, the resilience of its business model and the impact of climate change on its financial statements." The [FRC's year-end letter to CEOs, CFOs and Audit Committee Chairs](#) highlights that "users expect companies to provide full information about the future impact of climate change on the business and how the company's activities affect the environment" and that financial statements should explain the impact of climate-related risks, policies and strategies on measurement and disclosure.

The path to mandatory TCFD (*Task Force on Climate-related Financial Disclosures*) reporting is also clear:

- TCFD disclosures are required under a new listing rule for all premium listed companies, initially, on a comply or explain basis **from 1 January 2021**;
- The UK Government has published a consultation on requiring mandatory climate-related disclosures for publicly quoted companies, large private companies and LLPs in line with the four pillars of TCFD and its roadmap towards mandatory climate-related disclosures across the economy by 2025; and
- The European Commission (EC) has published proposals for a Corporate Sustainability Reporting Directive (CSRD) that would make sustainability reporting mandatory for all EU listed and large companies. The EU has stated that its approach to standard-setting should take account of existing standards and frameworks, including TCFD. TCFD is already included in voluntary guidance on the Non-Financial Reporting Directive.

ACTION: Climate change is a strategic issue and should continue to be on the Board agenda. We therefore expect the narrative within the Annual Report and Accounts to include the following:

- An explanation of how climate change is assessed as a strategic issue.
- Clarity of whether climate change represents a principal or emerging risk and how it is being managed.
- If climate-related targets or metrics are disclosed, an explanation of how those targets or metrics fit into strategic targets/ approach.
- An assessment of the readiness to make disclosures in line with the four areas recommended by the TCFD.

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 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 property specialists to support the audit team in our work on the valuation of land and buildings.

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 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 years' audits as well as planning guidance published by Audit Scotland. The following pages summarise the significant risks identified and our planned audit response.



The Scottish Public Finance Manual (SPFM) explains that accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value (BV). We are required to consider the organisational arrangements in place in this regard as part of our wider scope work.

Wider scope requirements (continued)

Audit dimensions (continued)

| Audit dimension | Significant risks identified | Planned audit response |
|--------------------------|---|--|
| Financial sustainability | <p>The pandemic continues to present a risk to the achievement of the commercial income target, and therefore the ability to achieve short term financial balance. The latest forecasts indicate that the targets, set as part of the budget and agreed with the Scottish Government as part of the Spending Review, will be met. However, this is dependent on the continued recovery of visitor numbers. Future year funding has not yet been confirmed.</p> <p>While HES has historically achieved short-term financial balance, it has not yet refreshed the medium-to-long term Financial Strategy due to the level of uncertainty that remains, however, this is planned for 2022. There remains a significant risk that robust medium-to-long-term planning arrangements are not in place to ensure that HES can manage its finances sustainably and deliver against its Corporate Plan.</p> | <p>We will assess the development of the 2022/23 budget and its links to outcomes in the Corporate Plan. We will also assess the progress in developing the medium-to-long-term Financial Strategy and linkages with the Project Management Office function and Workforce Plans.</p> |
| Financial management | <p>In previous years we have concluded that HES has strong financial management processes in place which are sufficiently robust to manage financial activity and capture and address any challenges to the achievement of financial targets.</p> <p>We have not identified any significant risks in relation to financial management during our planning.</p> | <p>We will continue to review the financial management arrangements.</p> |

Wider scope requirements (continued)

Audit dimensions (continued)

| Audit dimension | Significant risks identified | Planned audit response |
|-----------------------------|--|--|
| Governance and transparency | <p>In previous years we have concluded that robust governance and scrutiny arrangements were in place.</p> <p>We have not identified any significant risks in relation to governance and transparency as part of our planning work.</p> | <p>We will continue to monitor the developments of the proposed review of the management structure and the appointment of the new Chair to the Board.</p> <p>We will also follow up on our 2020/21 recommendation around the Board's approach to openness and transparency to assess any changes made during the year. However, we note that in agreeing this recommendation, it was agreed that management would work with the new Chair of the Board when appointed to consider and take forward, therefore we do not expect this to be fully implemented during the current audit year.</p> |
| Value for money | <p>In previous years we concluded that there was a clear performance management framework in place and performance was consistently high.</p> <p>We have not identified any significant risks in relation to value for money from our planning work.</p> | <p>We will follow-up on our 2020/21 recommendation around the planned review of the performance management assessment process to consider how the impact of actions can be measured.</p> <p>We will also follow up on any progress made in considering having an independent review of the self-assessment process, as recommended in our 2020/21 audit.</p> |

Wider scope requirements (continued)

Other requirements

National Fraud Initiative (NFI)

The NFI in Scotland is a biennial counter-fraud exercise led by Audit Scotland, and overseen by the Cabinet Office for the UK as a whole. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems that might suggest the existence of fraud and error.

Participating bodies received matches for investigation from January 2021. Most matches should have been investigated by 30 September 2021 and the results recorded on the NFI system. However, some investigations may continue beyond this date.

We must complete a short questionnaire for each body participating in the NFI and submit to Audit Scotland by 28 February 2022.

Other areas

We are required to also carry out the following areas of work:

- Preliminary enquiries on all correspondence received.
 - Submission of fraud returns.
-

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.

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.

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.

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 | 18 January 2022

Technical update and sector developments



Changes to the Government Financial Reporting Manual (FReM)

2021/22 Edition

Background

HM Treasury has issued a revised version of the FReM for the financial year 2021/22. The FReM is the technical accounting guide to the preparation of the annual report and accounts.

The main changes in the 2021/22 edition of the FReM apply to the Remuneration and Staff Report and relate to:

- additional guidance and reporting requirements for a single total figure of remuneration table (paragraphs 6.5.8e to 6.5.15)
- Revised disclosures for fair pay (6.5.19 to 6.5.24)

We have provided management with detailed guidance to help ensure compliance with the above. We have also provided management with a paper summarising the key sections of the FReM which we recommend is used as a 'checklist' to ensure that the mandatory requirements are met, from both the *letter* and the *spirit* of the requirements. These should be considered from the users of the accounts perspective, who may not necessarily be as informed/ knowledgeable as the entity on the matters being disclosed.

Next steps

We recommend that management review the changes to the FReM at the earlier opportunity, with particular reference to our detailed guidance note. We are happy to have early discussion on this to agree proposed amendments.

Sector developments

Charity fraud awareness

As part of charity fraud awareness week in October 2021, the Charity Commission for England and Wales has joined with the Fraud Advisory Panel to launch a new website addressing fraud risks posted to charities ([Home Page - Prevent Charity Fraud](#)).

This includes resources for both charities and professional advisors, such as help sheets on topics including cyber security and financial crime risks, as well as more specialised areas such as volunteer fundraising fraud and legacy fraud.

A review by the Association of Certified Fraud Examiners in 2021 identified that the average organisation loses 5% of revenue to fraud each year, with a typical fraud case lasting 14 months before detection. Similarly, research by the Charity Commission in 2019 ([Preventing Charity Fraud - insights and action](#)) identified that over two-thirds of charities see fraud as a major risk, but less than 9% have a fraud awareness training programme in place.

In response to Covid-19 and the ongoing changes in working environments as restrictions ease, we would recommend that trustees review their controls, or management's assessment of

the control environment and be particularly mindful of where controls have changed, in order to assure themselves that the controls remain suitable to address the risks.

Climate change

Consideration of the impact on the audit annual report and accounts

Role of Audit

In June 2021, the Auditor General for Scotland published a blog “making climate change an audit priority” that sets out the challenges for the public sector in tackling climate change and the role audit could play in this.

In July, Audit Scotland held a roundtable to help inform its approach to auditing climate change. The roundtable was made up of the climate change leads for the Accounts Commission and key stakeholders from across Scotland. They posed some challenging questions around the opportunities and challenges of tackling climate change and what it meant for the public sector. Several **key themes and challenges** emerges which were published in an update in October 2021 [Auditing climate change: An update \(audit-scotland.gov.uk\)](https://www.audit-scotland.gov.uk):

- Climate ambition v plans and actions.
- Importance of adaption.
- Paying for it.
- Critical role of the public.
- Joined up working.
- Public sector leadership role.

The time is right for independent audit and scrutiny to help achieve Scotland’s climate change ambitions.

Annual Report and Accounts considerations

As part of our planning discussions with management, we have shared an illustrative framework. The potential impacts of climate change are extensive and pervasive, therefore we recommend the framework is adopted and continually reviewed. Specific areas to start considering in advance of drafting the Annual Report and Accounts include key risks, mitigating actions (for **narrative disclosure**) and impact on **judgements and estimates** made by management:

Acute physical risks, e.g. extreme weather events causing supply chain disruption or severe damage to PPE.

Chronic physical risks, e.g. rising sea levels causing damage to PPE; or increased temperatures resulting in higher heat stress to employees.

Policy and Legal transition risks, e.g. direct and indirect tax compliance as tax legislation develops.

Technology transition risks, e.g. development and use of emerging technologies such as renewable energy and battery storage.

Market transition risks, e.g. changing consumer trends resulting in services becoming obsolete.

Reputation transition risks, e.g. damage to reputation through failure to transition effectively to a lower-carbon economy.

Financing Risks.

The State of the State 2021-22

Towards a new public sector normal

Background and overview

Now in its ninth year, this report brings together Deloitte and think tank Reform to provide an annual snapshot of the UK's public sector.

This year's report features an exclusive Ipsos MORI survey of more than 5,000 members of the UK public – including almost 900 Scottish adults – plus analysis of interviews with more than 50 senior figures across the UK's public sector. This blend of quantitative and qualitative research offers a unique perspective on government and public services.

What will I learn from this year's State of the State?

Since March 2020, the UK's governments and public services have led radical, exhaustive, and dynamic responses to the coronavirus pandemic. This year's State of the State finds them dealing with both the pandemic and its wider repercussions as a 'new normal' emerges.

Looking beyond the pandemic, the UK Government has set out its ambition to 'build back better' through infrastructure investment, levelling up economic outcomes across the regions and revitalising the UK's place in the world. At the same time, the policies and politics of Scotland, Northern Ireland and Wales continue to diverge from Westminster and Whitehall as well as each other. The State of the State explores all of these developments.

Next steps

A summary of some of the key Scottish findings are provided on the next page. The full report is available at [The State of the State 2021/22 \(deloitte.com\)](https://www.deloitte.com/uk/en/sectors/public-sector/state-of-the-state-2021-22.html)



The State of the State 2021-22 (continued)

Towards a new public sector normal (continued)

Public spending

This year has seen a shift in attitudes to public spending amongst Scottish people. Historically, the keenest in the UK on a higher tax and higher spend environment, views in Scotland are now broadly the same as those in the rest of the UK; possibly driven by the cost of the pandemic on the public purse and worries over household incomes.

29% of the public want to see higher levels of spending after the pandemic.

30% want to see the same balance of tax and spending as before the pandemic began.

27% would like to see tax cuts and spending cuts to match.



Social mobility

40% of Scots believe skills and employability are the most important factors when trying to get ahead in life. However, Scots feel more strongly than the UK average that wealth and region are also important indicators on getting ahead in society.



Spending priorities

The Scottish public's views were in line with the rest of the UK with public health and social care the most frequently named priorities.

Support for the growth in green industries and technologies is also high in Scotland, sitting behind housing but on a par with primary and secondary schools and reducing inequality between UK regions.

Appendices



Prior year audit adjustments

Uncorrected misstatements

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

| | | Debit/ (Credit) Statement of Financial Activity £m | Debit/ (Credit) in Net Assets £m | Debit/ (Credit) prior year Funds £m | Debit/ (Credit) OCI/Funds £m |
|------------------------------|-----|---|--|---|------------------------------------|
| Factual Misstatements | | | | | |
| | | | | - | - |
| Support Costs | [1] | (0.234) | 0.234 | - | - |
| Total | | (0.234) | 0.234 | Nil | Nil |

[1] During the audit, a significant movement in the 'Information Systems' category of 'Support Costs' was noted. A detailed analysis was performed of this movement, with this analysis identifying a number of invoices which were incorrectly recorded in 2020/21 due to human error, which consequently overstated expenditure by £0.234m, and understated net assets by the same amount.

We obtained written representations from the HES Board confirming that after considering all these uncorrected items, both individually and in aggregate, in the context of the consolidated annual 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.



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 plan to involve 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 Committee for the year ending 31 March 2022 in our final report to the Audit Committee.

Fees

The audit fee for 2021/22, in line with the fee range provided by Audit Scotland is £81,630, as analysed below:

| | £ |
|-------------------------------|---------------|
| Auditor remuneration | 63,840 |
| Audit Scotland fixed charges: | |
| Pooled costs | 14,760 |
| Contribution to AS costs | 3,030 |
| Total proposed fee | 81,630 |



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

Executing high quality audits remains our number one priority. We are committed to our critical public interest role and continue to embed our culture of quality and excellence into all of our people. This includes using new technology and tools to continue to transform our audit approach.

In July 2021 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 2020/21 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.

In that context, overall FRC inspection results, showing an improvement since last year from 76% to 79% of all inspections assessed as good or needing limited improvement, reflect the progress we are making. The overall profile of our ICAEW inspections and our internal inspection programme also show a similar overall improvement since last year.

The results for the inspections of FTSE 350 entities fell short of our overall scores, reflecting specific findings on those particular audits rather than issues pervasive across other audits. Our objective continues to be for all 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 agree with and accept the FRC’s findings on the individual inspections. The FRC has recognised improvements following the actions and programmes for previous years and we welcome the good practice points raised, including in respect of impairment and revenue where individual findings continue to occur.

Overall, we are pleased that there have been no significant findings over our firm wide processes and controls over the last three inspection cycles in the areas subject to rotational review by the FRC. However, we are continually enhancing our processes and controls across our business and such changes will directly or indirectly affect audit quality.

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 2020/21 Audit Quality Inspection Report on Deloitte LLP

“We reviewed 19 individual audits this year and assessed 15 (79%) as requiring no more than limited improvements. Of the 11 FTSE 350 audits we reviewed this year, we assessed eight (73%) as achieving this standard”.

“Our key findings related primarily to the need to:

- Improve the evaluation and challenge of management’s key assumptions of impairment assessments of goodwill and other assets.
- Enhance the consistency of group audit teams’ oversight of component audit teams.
- Strengthen the effectiveness and consistency of the testing of revenue.”

“The firm has taken steps to address the key findings in our 2019/20 public report, with actions that included increasing the extent of consultations, and enhanced learning, coaching and support programmes.

We have identified improvements, for example, in the extent of challenge of management by audit teams in respect of the estimates used for model testing. This was identified as a key finding last year.

We also identified good practice in a number of areas of the audits we reviewed (including robust procedures relating to going concern and evidence to support the challenge of management in areas of key judgement) and in the firm-wide procedures (including establishing a centre of excellence focused on credit for banking audits to encourage the consistent application of the firm’s methodology and guidance).“



Our approach to audit quality (continued)

Quality of public audit in Scotland – Annual Report 2020/21

Audit Scotland published its annual assessment of audit quality carried out on the audit work delivered by Audit Scotland and appointed firms. A copy of the full report is available: [Quality of public audit in Scotland annual report 2020/21 | Audit Scotland \(audit-scotland.gov.uk\)](https://www.audit-scotland.gov.uk/quality-of-public-audit-in-scotland-annual-report-2020-21)

The **public audit model in Scotland** is fundamentally different to the private sector audit regime and is well placed to meet the challenges arising from the reviews of the auditing profession.

The audit profession remains under scrutiny after high-profile corporate collapses in the private sector. The Brydon review, alongside the Kingman review, the Competition and Markets Authority market study of the audit services market and the Business, Energy and Industrial Strategy Committee's report on the Future of Audit all placed a strong focus on the need for independence of auditors from the bodies they audit.

Public audit in Scotland is well placed to meet the challenges arising from the reviews of the auditing profession. It already operates many of the proposed features to reduce threats to auditor independence including:

- independent appointment of auditors by the Auditor General for Scotland and Accounts Commission
- rotation of auditors every five years (current appointments extended to six years due to Covid-19)
- independent fee-setting arrangements and limits on non-audit services
- a comprehensive Audit Quality Framework.

Environment

The global pandemic has changed and challenged most aspects of our lives. Public bodies have been at the forefront of managing the effects of the COVID-19 pandemic. Public bodies have focused on supporting those most affected. Many bodies had new obstacles to overcome as they prepared financial statements and responded to auditors.

The Scottish Government delayed the accounting and auditing deadlines for NHS and local government bodies to help accommodate these competing pressures. The Auditor General for Scotland and Accounts Commission revised their work programme and prepared COVID-19 specific briefing papers to support public bodies and auditors to respond to the pandemic.

The Auditor General for Scotland and Accounts Commission recognised that the safety and wellbeing of audit staff and staff in public bodies was paramount and that auditors would need to take a pragmatic and flexible approach to their work in 2020/21. They were clear that audit quality should not be compromised.

Our approach to audit quality (continued)

Quality of public audit in Scotland – Annual Report 2020/21 (continued)

Key messages

1. The application of the Audit Quality Framework (AQF) continues to identify improvement areas and good practice in audit quality. Across the range of evidence used to assess audit quality the conclusion is that the quality of audit work is good in Performance audit and Best Value audit and accountancy firms, with improvement required and planned in Audit Scotland's Audit Services Group where the financial audit quality results do not meet the expected standards.

2. Areas of Good Practice

- ICAS have reviewed compliance with International Standard on Quality Control 1 for all auditors and did not note any issues or matters for further consideration. [\(One Deloitte file reviewed in 2020/21\)](#)
- All 2019/20 annual audit opinions were signed off by 9 March 2021. [\(All Deloitte opinions signed by 31 October 2020\)](#)
- Two financial audits reviewed were awarded the highest scores available by the Institute of Chartered Accountants of Scotland (ICAS) with no areas for improvement identified. [\(One Deloitte file reviewed – awarded score of 2A – limited improvement required\)](#)
- All of the Performance audit and Best Value audits reviewed achieved expected quality standards with limited concerns identified. All audit providers have confirmed that there continued to be a strong culture of support for performing high-quality audit during the pandemic. [\(One Deloitte Best Value file reviewed – awarded score of 2A – limited improvement required\)](#)
- Stakeholder feedback shows further improvement in the level of satisfaction with external audit services provided, the usefulness of the annual audit report and shows that audit work has had impact.

3. Areas for improvement

- Seven of the eleven (64 per cent) 2019/20 Audit Services Group financial audits reviewed did not meet the expected standard. [\(Not applicable to Deloitte audits\)](#)
- For two audits, auditors need to investigate the risk of material misstatement in the financial statements and ensure that any such misstatement is resolved appropriately. [\(Not applicable to Deloitte audits\)](#)
- An area that continues to be an issue for most audit providers is on audit staff views of having sufficient time and resources to deliver high quality audit. [\(An area continually monitored in planning all audits\)](#)



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