

# Historic Environment Scotland

Report to the Audit, Risk and Assurance Committee, the Board and the Auditor General for Scotland on the 2021/22 audit

Issued on 16 September 2022 for the ARAC meeting on 23 September 2022 and reissued for the Board meeting on 20 October 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 financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

I have pleasure in presenting our final report to the Audit, Risk & Assurance Committee “the Committee”) of Historic Environment Scotland (“HES”) for the year ending 31 March 2022 audit. The scope of our audit was set out within our planning report presented to the Committee in January 2022.

This report summarises our findings and conclusions in relation to:

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



# Introduction (continued)

## The key messages in this report (continued)

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

### **Conclusions from our testing.**

Based on our audit work completed to date we expect to issue an unmodified audit opinion.

Following minor adjustments by management, the performance report and accountability report comply with the statutory guidance and proper practice and are consistent with the financial statements and our knowledge of HES.

The auditable parts of the remuneration and staff report have been prepared in accordance with the relevant regulation.

A summary of our work on the significant risks is provided in the dashboard on page 9.

From audit work completed to date we have identified both corrected and uncorrected misstatements in the Financial Statements as detailed on page 31.

### **Conclusions on audit dimensions**

As set out on page 3, our audit work covered the four audit dimensions. Our audit work was risk based and proportionate, covering each of the four dimensions.

Our overall conclusions on each dimension are summarised below, with full details provided in the main body of the report:

### ***Financial Management***

HES continues to have 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. This is supported by an experienced finance team and a robust internal audit function, as well as appropriate arrangements for the prevention and detection of fraud and error.

### ***Financial Sustainability***

HES achieved short term financial balance in 2021/22 and has set a balanced budget for 2022/23 and is therefore financially sustainable in the short term.

While modelling has been carried out as part of the consultation process for the Scottish Government's Resource Spending Review to 2026/27, HES does not have updated Financial Strategy in place. It is therefore unable to demonstrate it is financially sustainable in the medium to longer term. HES is currently undertaking a review of its business model with options presenting different ways of achieving financial sustainability. HES plan to consider an updated Financial Strategy alongside it's business model review during 2022/23.

Work has progressed with the Project Management Office (PMO) during the year, and further plans are in place to develop an approach to benefit measurement and realisation. This is a critical element to be able to demonstrate that the projects in place are achieving the desired outcomes. Regular reporting of key projects is reported to the PMO Board, SMT and Finance committee.

# Introduction (continued)

## The key messages in this report (continued)

### Conclusions on audit dimensions (continued)

#### *Governance and transparency*

HES continues to have strong leadership in place. The Board has seen a change to the Chair during the year and a restructure of the Senior Management Team, although minimal changes in the individuals within the team. The governance arrangements continue to be robust, with a strong Audit, Risk & Assurance Committee demonstrating areas of good practice.

We are pleased to note that the Board no longer holds closed sessions. While the Board has considered and decided against publishing papers along with minutes of Board meetings, we recommend that this position is regularly reviewed as is out of line with other public sector bodies.

#### *Value for money*

HES continues to have a clear performance management framework in place and performance continues to be strong. We are pleased to note that our recommendation to incorporate success measures was taken on board in developing the 2022/23 Annual Operating Plan (AOP), and there is a commitment by management to undertake work on an impact measurement framework during 2022/23.

We are also pleased to note that there has been some initial discussions with potential peer organisations to review the performance framework and self-assessment process.

#### *Best value*

HES has sufficient arrangements in place to secure best value with a strong focus on continuous improvement. It has a clear understanding of areas which require further development.

### Next steps

An agreed Action Plan is included in the Appendix on pages 33 to 37 of this report, including a follow-up of progress against prior year actions.

### Added value

Our aim is to add value to HES by providing insight into, and offering foresight on, financial sustainability, risk and performance by identifying areas for improvement and recommending and encouraging good practice. In so doing, we aim to help HES promote improved standards of governance, better management and decision making, and more effective use of resources. This is provided throughout the report.

### 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 Historic Environment Scotland, by working in partnership with Audit Scotland and the incoming auditors.

We would like to put on record our thanks to the Board, management and staff for the good working relationship over the period of our appointment.

**Pat Kenny**  
Associate Partner
























# Annual Report and Financial Statements Audit



# Quality Indicators

## Impact on the execution of our audit

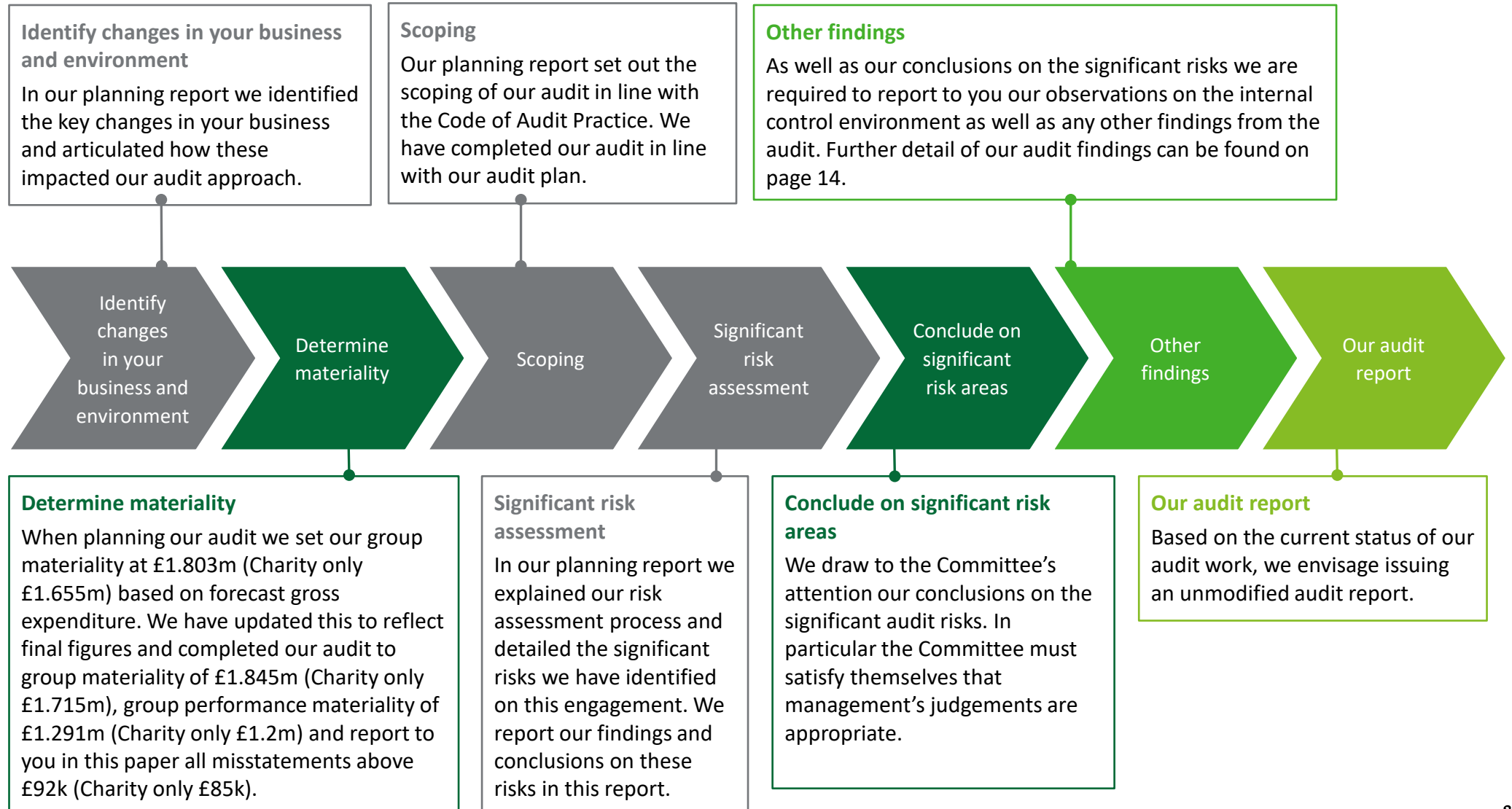
Management and those charged with governance are in a position to influence the effectiveness of our audit, through timely formulation of judgements, provision of accurate information, and responsiveness to issues identified in the course of the audit. This slide summarises some key metrics related to your control environment which can significantly impact the execution of the audit. We consider these metrics important in assessing the reliability of your financial reporting and provide context for other messages in this report.

Area	Grading			Reason
	FY22	FY21	FY20	
Timing of key accounting judgements				Documentation in relation to key areas of judgement in relation to property valuations, dilapidations and provisions was provided early in the audit process.
Adherence to deliverables timetable				The audit of the Annual Report and Financial Statements progressed largely in line with the anticipated timescale, with key deadlines, such as the first draft of the Financial Statements, being met.
Access to finance team and other key personnel				Deloitte and HES have worked together to facilitate remote communication during the audit which has been successful.
Quality and accuracy of management accounting papers				On the whole documentation provided has been a good standard. However, we encountered some issues with the documentation and evidence provided for accruals and grants payables. Fewer than 10% submissions by management required revision.
Quality of draft financial statements				A draft of the Financial Statements was received on the 10 June which contained almost all disclosures. A second draft, containing some of the missing notes, was received on the 20 June. The number and magnitude of errors identified within the Financial Statements has reduced significantly from the prior year.
Response to control deficiencies identified				We have raised an control deficiency in relation to the grants process (page 14) as a result of the issues identified within the grant liability and the underlying cause being the process. Management have agreed to review this control for future years.
Volume and magnitude of identified errors				We have identified six financial adjustments to date as detailed on page 31 - 32. We have identified a small number of disclosure adjustments which could have been prevented by a more detailed management review of classification.

 Lagging     Developing     Mature

# Our Audit Explained

We tailor our audit to your business and your strategy





# Significant Risks

## Dashboard

Risk	Material	Fraud risk	Planned approach to controls testing	Controls testing conclusion	Consistency of judgements with Deloitte's expectations	Comments	Page no.
Completeness of Commercial Income			D+I	Satisfactory		Satisfactory	10
Management override of controls			D+I	Satisfactory		Satisfactory	11

Overly prudent, likely to lead to future credit



Overly optimistic, likely to lead to future debit.

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

# Significant Risks (continued)

## Completeness of Commercial Income



### Risk identified and key judgements

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 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 was our key area of audit focus.



### Deloitte response

We have performed the following:

- Obtained an understanding of the design and implementation of the key controls in place in relation to recording of commercial income;
- Performed analytical procedures over commercial income reported for the year, based on visitor numbers and price changes, to confirm accuracy; and
- Performed detailed testing of the year-end control account reconciliation, being the difference between the amounts uploaded from the Galaxy system, and the amounts uploaded from the bank statements, to gain assurance over completeness of amounts recognised as income in the Annual Report and Financial Statements.

### Deloitte view

We have concluded that commercial income has been recognised in accordance with the Charities SORP and FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland.

# 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 financial statements 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 Financial Statements and accounting records.



### Deloitte response and challenge

In considering the risk of management override, we have performed the following audit procedures that directly address this risk:

#### Journals

We have tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the Annual Report and Financial Statements. In designing and performing audit procedures for such tests, we have:

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

### Accounting estimates and judgements.

We have reviewed 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 have:

- Evaluated whether the judgments and decisions made by management in making the accounting estimates included in the Annual Report and Financial Statements, 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. From our testing we did not identify any indications of bias. A summary of the key estimates and judgements considered is provided on the next page; and
- Performed a retrospective review of management judgements and assumptions related to significant accounting estimates reflected in the Annual Report and Financial Statements of the prior year.

### Significant and unusual transactions

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

### Deloitte view

We have not identified any instances of management override of controls and our testing in this area is satisfactory.

# Significant Risks (continued)

## Management override of controls (continued)

**Key estimates and judgements** The key estimates and judgments in the Annual Report and Financial Statements includes those which we have selected to be significant audit risks around Commercial Income (see page 10). This is inherently the area in which management has the potential to use their judgement to influence the Annual Report and Financial Statements. As part of our work on this risk, we reviewed and challenge management’s key estimates and judgements including:

Estimate / judgement	Details of management’s position	Deloitte Challenge and conclusions
Dilapidations Provision	HES provide for legal or constructive obligations that are of uncertain timing or amount at the balance sheet date on the basis of the best estimate of the expenditure required to settle the obligation. A dilapidations provision of £2,127k was made in respect of a leased properties at John Sinclair House, Longmore House and Other Properties.	<p>Dilapidations have increased by approximately £160k during 2021/22, mainly arising from offsetting movements in the provision for John Sinclair House &amp; Longmore House.</p> <p>We have challenged the 2021/22 provision, including management’s judgements and supporting documentation, by creating our own point estimate for the provision. Through this, we have not identified any factors that would suggest management have used their judgement to inappropriately influence the Annual Report and Financial Statements.</p>
Legal Provision	HES provides for any legal claims which HES has probable liability for and can be measured reliably. Management have included a provision £528k to cover outstanding legal claims and a reimbursement asset of the same value.	<p>We have assessed the legal claims outstanding at 31 March 2022 alongside the legal team to determine the probability of HES having liability. In line with FRS 102, the recognition criteria for provisions and reimbursement assets are separate and management have recognised these separately.</p> <p>Provision: We reviewed and requested information from the HES legal team and HES insurance providers regarding ongoing cases including those covered by insurance. We considered management’s estimate and supporting documentation, and concluded that the amount provided was reasonable.</p> <p>Reimbursement Asset: We reviewed evidence provided by insurers to consider whether the reimbursement was virtually certain in line with FRS 102. We considered management's estimate and based on this and our audit work, concluded that the amount recognised was reasonable.</p>

# Significant Risks (continued)

## Management override of controls (continued)

Estimate / judgement	Details of management's position	Deloitte Challenge and conclusions
Grant Commitments	<p>Under the Charities SORP the award of a grant is recognised as a liability when the criteria for a constructive obligation are met, payment is probable, it can be measured reliably, and there are no conditions attached to its payment that limit its recognition.</p> <p>HES has recognised £34m of grant commitments as at 31 March 2022, up from £31m at 31 March 2021.</p>	<p>We have tested a sample of grant accruals, commitments and retentions at the year-end to assess whether they have been accounted for in accordance with the SORP.</p> <p>The increase in commitments is due to the impact of COVID-19 on prior year commitments, which had reduced in line with reduced activity during the pandemic. It was expected that commitments would increase as HES income returned to levels similar to that seen prior to the pandemic.</p> <p>We have identified adjustments in relation to the grants balance as noted on pages 31 - 32. These were due to commitments that HES no longer had a liability for given the time elapsed since the end of the award period</p>
Property Valuations	<p>HES is required to hold property assets within Fixed Assets at a modern equivalent use valuation. The valuations are, by nature, estimates based on specialist and management assumptions and which can be subject to material changes in value.</p> <p>HES has had an independent valuation carried out at 31 March 2022 by its independent valuers in accordance with its 5-year rolling programme.</p> <p>The valuation method has not changed from the prior year and is in line with FRS 102.</p>	<p>We have confirmed that the valuer and the methodology applied has not changed in the year. We have challenged management's assessment and consulted with our internal property specialists. For those valued on Existing Use Value on a market comparable basis, our property experts have confirmed that minimal market value movement would be expected in 2021/22. For those valued on a Depreciated Replacement Cost basis, which would be impacted by changes in build costs during the year, we have performed an analysis of changes in the Build Costs Information Service index ('BCIS') and concluded that management's assessment of the BCIS impact is reasonable.</p> <p>We are therefore satisfied that there is no indication of a material movement in assets not formally revalued during the year.</p>


### Deloitte view

From our review of the dilapidations provision, the legal provision, Grant Commitments, and Property Valuations, we have not identified any instances of management override of controls in relation to the specific transactions tested. We have however identified adjustments for grant commitments as detailed on pages 31 - 32

# Other Significant Findings

## Internal control

During the course of our audit we have identified one internal control finding, which we have included below for information.

Area	Observation	Priority
Grant Processes	<p>During our audit, we have identified a number of errors in relation to the value of grant liabilities recognised in the financial statements. When reviewing the cause of the errors, it is clear that the processes involved in managing the grants on an ongoing basis is heavily reliant on manual intervention. This means that there is a risk of error at most stages in the process and that there is a significant burden on staff time to complete the necessary preparatory work and for reviews of this work to be conducted.</p>	

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

Low Priority

Medium Priority

High Priority



# Other Significant Findings

## Financial reporting findings

Below are the findings from our audit surrounding your financial reporting process.

### Qualitative aspects of your accounting practices:

The HES Annual Report and Financial Statements have been prepared in accordance with the Charities SORP. The accounting policies in place are considered appropriate for the organisation.

### Other matters relevant to financial reporting:

We have not identified other matters arising from the audit that, in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

### Significant matters discussed with management:

Significant matters discussed with management related primarily to the impact of COVID-19 on the organisation, the basis of assessment relation to the going concern assumption and the assessment of significant judgements and estimates.

We will obtain written representations from the Board on matters material to the financial statements when other sufficient appropriate audit evidence cannot reasonably be expected to exist. A copy of the draft representations letter will be circulated separately.

# Our Audit Report

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

Here we discuss how the results of the audit impact on other significant sections of our audit report.



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

Our opinion on the financial statements is expected to be unmodified.



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

We have not identified a material uncertainty related to going concern and will report by exception regarding the appropriateness of the use of the going concern basis of accounting. Further information is provided on page 17.



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

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

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



### **Other reporting responsibilities**

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

### **Opinion on regularity**

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

Our opinion on matters prescribed by the Auditor General for Scotland are discussed further on page 17.

# Your Annual Report

We are required to provide an opinion on the auditable parts of the Remuneration and Staff report, the Annual Governance Statement and whether the Performance Report is consistent with the disclosures in the Financial Statements.

	Requirement	Deloitte response
The Performance Report	The report outlines the HES's performance, both financial and non-financial. It also sets out the key risks and uncertainty as set out in the Annual Operating Plan.	We have assessed whether the Performance Report has been prepared in accordance with the Accounts Direction. We have also read the Performance Report and confirmed that, after minor changes, the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and in accordance with the relevant guidance.
The Accountability Report	Management have ensured that the accountability report meets the requirements of the FReM, comprising the governance statement, remuneration and staff report and the parliamentary accountability report.	<p>We have assessed whether the information given in the Governance Statement is consistent with the financial statements and has been prepared in accordance with the accounts direction.</p> <p>We have also read the Accountability Report and confirmed that the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading. Minor changes were identified during the course of the audit, which management have actioned, ensuring that the Governance Statement and Accountability Report have been properly prepared in accordance with the relevant guidance.</p> <p>We have also audited the auditable parts of the Remuneration and Staff Report and confirmed that it has been prepared in accordance with the accounts direction, including new requirements around percentile pay.</p>
Going Concern	Management has made appropriate disclosure relating to Going Concern matters	As per our judgement on page 16, We are satisfied from a review of the 2022/23 budget, correspondence with the Scottish Government, consideration of the actual position to date in 2022/23, and the assumption of continued provision of services set out in the FReM and Practice Note 10, that it is appropriate to prepare the Financial Statements on a going concern basis, and that no material uncertainty on going concern exists. Management have appropriately included going concern as a critical judgement in the notes to the Financial Statements.

# Audit Dimensions



# Financial management



## Significant risks identified in Audit Plan

In previous years we have concluded that HES had strong financial management processes in place which were sufficiently robust to manage financial activity and capture and address any challenges to the achievement of financial targets. We therefore did not identify any significant risks in relation to financial management during our planning. We have continued to review the arrangements in place as summarised on the following pages.

## Current year financial performance

The 2021/22 budget was approved by the Board in March 2021, being a balanced budget of £79.9m. This incorporated a vacancy factor of £3m. The budget has been updated throughout the year to include in year movements. The final outturn reported in the Annual Report and Financial Statements was a small surplus of £0.7m (1%). The Senior Management Team and the Finance Committee and Board regularly review progress against budget throughout the year, with quarterly reporting to the Committee. From review of the reporting throughout the year, variances are clearly reported and explained.

The COVID-19 pandemic has continued to have an impact on the financial position of HES. Total income increased by 4% in comparison with 2020/21, with a reduction in Grant-in-Aid being offset by a partial recovery in commercial income. However, commercial income of £21.4m is still 66% below the pre-pandemic levels (£52.6m). Grant-in-Aid remained at significantly increased levels compared with pre-pandemic. This continues to be a key risk to HES and is closely monitored as part of the reporting to the Finance Committee.

As part of the 2021/22 budget setting, HES created a designated reserve of £1.5m (subsequently increased to £2m) to fund repairs to properties in care in future years. The fund was set up from membership income which has not been utilised for repairs during 2020/21 as a result of COVID-19 restrictions. This fund was not utilised during 2021/22 due to continued operational challenges caused by the pandemic, but is expected to be fully utilised during 2022/23.

HES also has an Investment Plan in place, with progress reported regularly to the Finance Committee. £5.9m of capital expenditure was incurred during 2021/22, bringing the total spent over the last 5 years to enhance the condition of sites, improve the experience of visitors and improve corporate systems to £41.7m.

# Financial management (continued)

## Finance capacity

The finance team has remained consistent throughout the year. As reported in our 2020/21 annual report, the teams capacity had been impacted by the implementation of the new finance system, however improvements were noted in 2021/22 and this is being well managed.

## Internal audit

We have assessed the internal audit function, including its nature, organisational status and activities performed. We have reviewed all internal audit reports published throughout 2021/22. The conclusions have helped inform our audit work, although no specific reliance has been placed on this work.

The 2021/22 Internal Audit Plan was approved by the ARAC in two parts, with a plan for the first 6 months approved in February 2021 and a plan for the remaining 6 months approved in July 2021. This was to allow for flexibility as HES adapted to the ongoing impact of COVID-19.

The Internal Audit Annual Opinion for the year ended 31 March 2022 was approved by the ARAC in April 2022, giving an overall Annual Assurance Opinion as “satisfactory”.

The Head of Internal Audit left HES in May 2022 and a new postholder is now in place. A report to the ARAC in April advised that HES’s engagement Partner with Azets would provide interim cover for any required Head of Internal Audit activity and confirmed that there was not any expected impact on the overall delivery of the 2022/23 Internal Audit Plan.

We have considered the work of internal audit as part of our audit work on the Annual Governance Statement as discussed further on page 17.

## Standards of conduct for prevention and detection of fraud and error

We have assessed HES’s arrangements for the prevention and detection of fraud and irregularities. This has included specific considerations in response to the increased risk of fraud as a result of COVID-19. Overall, we found the arrangements to be to be designed and implemented appropriately.

## National Fraud Initiative (NFI)

A number of public sector bodies, including HES are participating in the most recent NFI exercise which commenced in 2020/21. We have continued to monitor the HES’s participation and progress in the NFI during 2021/22 and submitted an assessment of the participation to Audit Scotland in February 2022. The information submitted was used by Audit Scotland the August 2022 national NFI report. We concluded that the HES was fully engaged in the exercise.

In line with the Audit Scotland report published on the 2018/19 exercise, we would encourage the ARAC and staff leading the NFI work review the NFI self appraisal checklist for future exercises.

### Deloitte view – financial management

HES continues to have 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. This is supported by an experienced finance team and a robust internal audit function, as well as appropriate arrangements for the prevention and detection of fraud and error.



# Financial sustainability

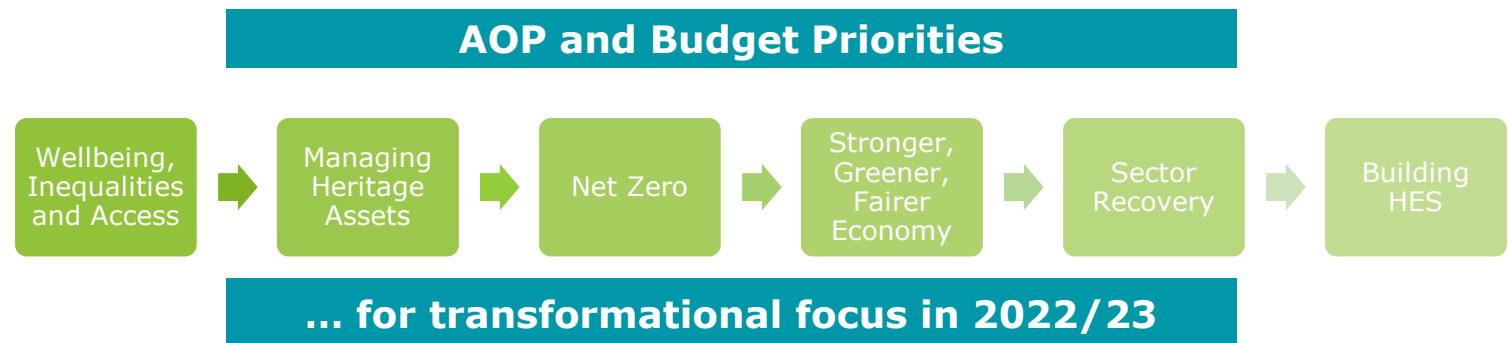


## Significant risks identified in Audit Plan

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 was 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. We have therefore considered the 2022/23 budget setting process and the progress made in developing the medium-to-long-term Financial Strategy and how this is linked to the Project Management Office function and Workforce Plans.

## 2022/23 budget setting

The initial budget requirements indicated a budget shortfall of £20m. A prioritisation exercise was then undertaken through focussing on aligning discretionary elements of the Corporate Plan and AOP. As the majority of HES's cost base is fixed or focused on core delivery with only the Investment Plan and a small proportion of the operating costs providing any real scope for prioritisation. The prioritisation was guided by the principles illustrated below.



The Board approved a balanced budget of £104.4m in April 2022. The budget was developed in conjunction with the Annual Operating Plan (AOP) with Directorate budget submissions supporting delivery of the AOP. The submissions were built on the approved budgets for 2020/21 and 2021/22 which by necessity due to loss of income reflected a minimum requirement to deliver core activity. As such a largely zero-based approach has been taken. In line with our previous recommendations, we are pleased to note that the approved budget included an analysis of how the budget aligned to the corporate outcomes at a Directorate level.

# Financial sustainability (continued)

## 2022/23 budget setting (continued)

In setting its budget the Board has recognised that several risks exist including:

- Continued uncertainty regarding COVID-19 and the rate at which visitor numbers will recover once restrictions are lifted coupled with the ongoing closure of sites linked to the High Level Masonry work. This will primarily impact the commercial income generation.
- Original operational expenditure budget based on inflation of 3.2%, however, the current Bank of England forecasts have inflation potentially reaching 13.3%. This would lead to being able to deliver less with available resource and may lead to cost pressures where the spend is unavoidable
- There may be external pressures to return to Grants programmes to the historic £14.5m level of funding.

As part of the approved budget is £9.5m for Investment Plan projects. This includes the following main projects:

- £1.5m - High Level Masonry Inspection project
- £3.3m – works programme across the Properties in Care (PIC) estate, mainly covering corrective and maintenance projects
- £1.1m – Archive House Project
- £1.7m – Heritage Hub project

## Medium-to-long term financial planning

In our 2020/21 annual audit report we highlighted that the Financial Strategy had not been updated due to the level of uncertainty as a result of the COVID—19 pandemic.

The development and approval of a new Financial Strategy has been further delayed in order to align with the Scottish Government’s Resource Spending Review (RSR). HES provided input into the RSR during the consultation process which incorporated longer term financial modelling. The RSR was ultimately published by the Scottish Government in May 2022 which set out indicative funding for the 4 years from 2023/24 to 2026/27 along with an update on the previously published Capital Resource Review. HES is currently undertaking a review of its business model with options presenting different ways of achieving financial sustainability. HES therefore plan to consider an updated Financial Strategy alongside it’s business model review during 2022/23.

# Financial sustainability (continued)

## Programme Management Office (PMO)

In our 2020/21 annual audit report we highlighted to progress that was being made in implementing the PMO. The aim of the PMO is:

*“to set projects up for success, add value to the project lifecycle from initiation to benefits realization, and drive value from the portfolio as a whole to support delivery of ‘Heritage for All’”.*

During 2021/22, the PMO Board was established, along with recruitment of a permanent Head of PMO and the creation of a PMO Team. A Project Manager’s Network has also been created.

As reported in the Annual Report and Financial Statements, work is ongoing to develop and embed good practice, including the development of an approach to benefits measurement and realisation, which can be adapted to support good practice approaches in the variety of projects being undertaken.

The key projects that are currently being supported by the PMO are as following, with current status as discussed by the PMO Board in March 2022:

Project	Status
Document Centre	Amber
PICAMS Phase 2	Amber
CMIS Phase 2	Green
Archive House	Amber
Heritage Hub	Green
Tier 1 High Level Masonry	Amber

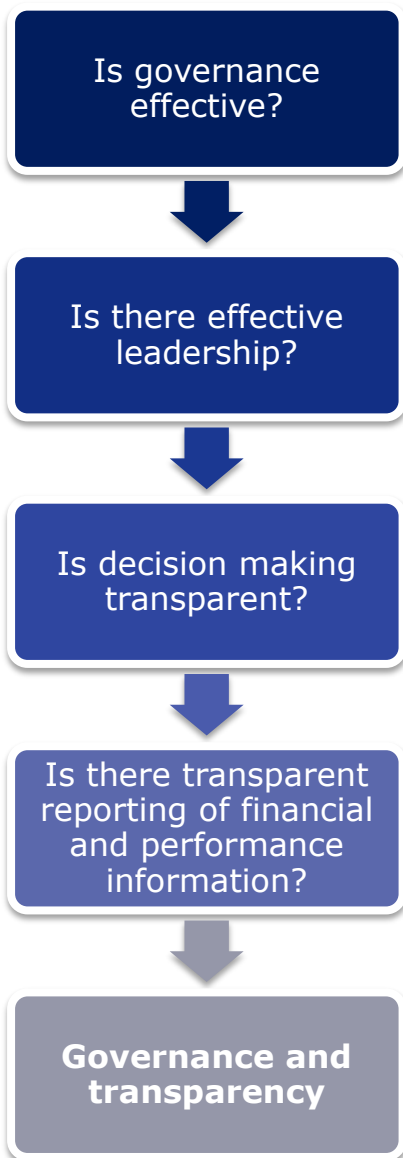
## Deloitte view – Financial sustainability

HES achieved short term financial balance in 2021/22 and has set a balanced budget for 2022/23 and is therefore financially sustainable in the short term.

While modelling has been carried out as part of the consultation process for the Scottish Government’s Resource Spending Review, HES does not have an updated Financial Strategy in place. It is therefore unable to demonstrate it is financially sustainable in the medium to longer term. HES is currently undertaking a review of its business model with options presenting different ways of achieving financial sustainability. HES therefore plan to consider an updated Financial Strategy alongside it’s business model review during 2022/23.

Work has progressed with the PMO during the year, and further plans are in place to develop an approach to benefit measurement and realisation. This is a critical element to be able to demonstrate that the projects in place are achieved the desired outcomes. Regular reporting of key projects is reported to the PMO Board, SMT and Finance Committee.

# Governance and transparency



## Significant risks identified in Audit Plan

In previous years we have concluded that robust governance and scrutiny arrangements were in place. We therefore did not identify any significant risks in relation to governance and transparency as part of our planning work. We have continued to monitor the developments of the proposed review of the management structure and the appointment of the new Chair of the Board as summarised on the following pages.

## Leadership

As reported in our 2020/21 annual audit report, the Chief Executive instigated a management restructure which was progressed during 2021/22 to ensure that resources are allocated in the best way to achieve the outcomes in the Corporate Plan, “*Heritage for All*”. As a result, a number of changes have been made to the Senior Management Team during the year, however, the individuals within the posts have not significantly changed, as illustrated below.

Old Structure	New Structure
Chief Executive	Chief Executive
Director of Conservation	Director of Cultural Assets
Director of Finance and Performance	Director of Finance and Corporate Services
Director of Heritage	Director of Heritage
Director of Commercial and Tourism	Director of Marketing and Engagement
New role not in old structure	Director of Operations
Director of Development and Partnerships	Director of Partnerships and External Relations
Director of People	Director of People
Director of Corporate Services	Project Director
Director of Communications	<i>Role not in new structure</i>

The Chair of the Board changed in the year, with Hugh Hall being formally appointed in January 2022 for a period of 4 years.

Given the timing of these changes, it is too early to comment on how the transition has been implemented, although no specific areas of concern have been noted from our audit work.

# Governance and transparency (continued)

## Governance and scrutiny arrangements

We have reviewed meetings attendance from the past year and confirm that there has been adequate attendance at Board and Committee meetings. In addition, from attendance at meetings we can confirm that there is sufficient scrutiny and challenge exercised by Board members during the meetings.

The ARAC continues to be a key element of the governance arrangements in place. It has continued to provide oversight of the risk management activity during the year,

In line with good practice, the ARAC carried out an annual self assessment of its effectiveness at its meeting in April 2022. The results of the self assessment were reviewed in order to agree priorities for the ARAC development during the coming year.

## Openness and transparency

In our 2020/21 report we highlighted that while key corporate documents are published on the website, openness and transparency could be improved to bring HES into line with other public sector organisations. In particular, we recommended that consideration should be given to holding meetings in public and limit the number of closed sessions to private confidential information only.

We are pleased to note that following the appointment of the new Chair, no closed sessions have occurred and there are no proposals to hold these in the future.

In line with our recommendation, consideration has also been given to publishing papers along with the Board minutes, however, HES has decided to continue to publish minutes only. We recommend that this position is regularly reviewed as is out of line with other public sector bodies.

## Deloitte view – Governance and transparency

HES continues to have strong leadership in place. The Board has seen a change to the Chair during the year and a restructure of the Senior Management Team, although minimal changes in the individuals within the team. The governance arrangements continue to be robust, with a strong ARAC demonstrating areas of good practice.

We are pleased to note that the Board no longer holds closed sessions. While the Board has considered and decided against publishing papers along with minutes of Board meetings, we recommend that this position is regularly reviewed as is out of line with other public sector bodies.

# Value for money



## Significant risks identified in Audit Plan

In previous years we have concluded that there was a clear performance management framework in place and performance was consistently high, we therefore did not identify any significant risks in relation to value for money as part of our planning work. We have continued to review the performance reports presented at the Board to assess the extent of openness and transparency during the year, as summarised on the following pages, specifically following up on the recommendations made in our 2020/21 annual audit report.

## Performance management framework

In line with our previous years conclusions, HES has continued to have a clear performance management framework in place. The AOP for 2021/22 covers the third and final year of the three year Corporate Plan “*Heritage for All*”, which identifies priorities in relation to each of the five outcomes and Key Performance Indicators. Regular reporting is provided on how HES has delivered against these priorities, including the reporting within the Annual Report. In line with good practice, this also reports how HES’s performance contributes to the achievement of the Scottish Government’s strategic objectives and wellbeing outcomes.

In our 2020/21 annual audit report we recommended HES consider having an independent review of the self-assessment process, for example through a peer review. We are pleased to note that initial discussions have taken place and terms of reference are in development.

HES has undertaken a light-touch refresh of its Corporate Plan during 2021/22 to ensure that it remains fit for purpose for 2022/23. This refreshed Corporate Plan retains the same outcomes and KPIs. A full review will be undertaken following the publication of Our Place in Time and the National Performance Framework, which are currently under review and will be published in 2023.

In our 2020/21 annual audit report we recommended that HES consider whether the targets set are sufficiently focussed on measuring the impact of actions. We are pleased to note that this was taken on board in developing the 2022/23 AOP, and there is a commitment by management to undertake work on an impact measurement framework during 2022/23.

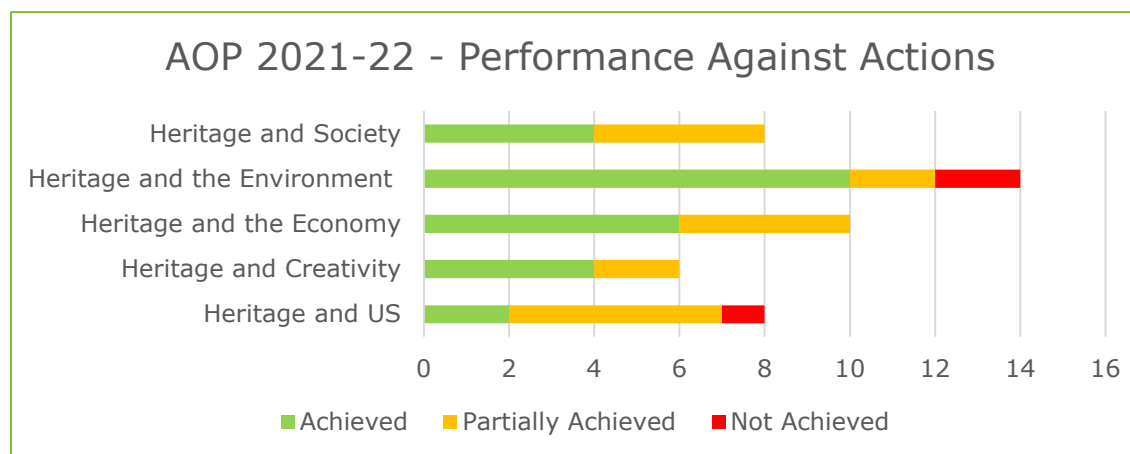
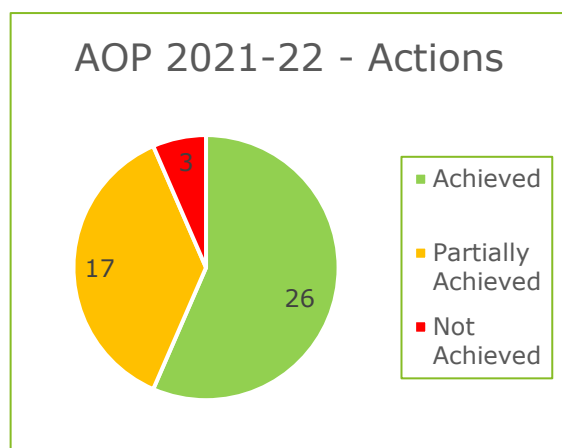
The AOP for 2022/23 outlines the planned activities to support the achievement of the outcomes in the Corporate Plan, with a particular focus on six priorities as noted on page 21.



# Value for money (continued)

## Performance data

HES has continued to report strong performance against its AOP, with 93% of its AOP achieved or partially achieved. Strong performance has also been reported against its KPIs in 2021/22 as illustrated below.



A detailed narrative has been included in the Annual Report on each of the KPIs and the action being taken to address those not achieved.

### Deloitte view – Value for money

HES continues to have a clear performance management framework in place and performance continues to be strong. We are pleased to note that our recommendation to incorporate success measures was taken on board in developing the 2022/23 AOP, and there is a commitment by management to undertake work on an impact measurement framework during 2022/23.

We are also pleased to note that there has been some initial discussions with potential peer organisations to incorporate an review the performance framework and the self-assessment process.

# Best value

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.

## **The duty of Best Value, as set out in the SPFM**

- To make arrangements to secure continuous improvement in performance whilst maintaining an appropriate balance between quality and cost; and in making those arrangements and securing that balance.
- To have regard to economy, efficiency, effectiveness, the equal opportunities requirement and to contribute to the achievement of sustainable development.

The SPFM sets out nine characteristics of Best Value which public bodies are expected to demonstrate. The refreshed guidance issued by the Scottish Government in 2011 focused on 5 generic themes and 2 cross-cutting themes, which now define the expectations placed on Accountable Officers by the duty of Best Value.

Five themes:

1. Vision and Leadership
2. Effective Partnerships
3. Governance and Accountability
4. Use of Resources
5. Performance Management

Cross-cutting themes:

1. Equality
2. Sustainability

HES has a number of arrangements in place to secure Best Value. This is evidenced through the Corporate Plan and the Annual Performance Reporting.

As noted elsewhere within this report, HES has an established governance framework and strong leadership and a culture of continuous improvement

HES recognises that it must deliver services within the financial resources available and, as noted elsewhere in this report, further work is required to achieve medium to longer term financial sustainability.

## **Deloitte view – Best Value**

HES has sufficient arrangements in place to secure best value with a strong focus on continuous improvement. It has a clear understanding of areas which require further development.

# Purpose of our Report and Responsibility Statement

Our report is designed to help you meet your governance duties

## What we report

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

Results of our work on key audit judgements and our observations on the quality of your Annual Report and Financial Statements.

Our internal control observations

Other insights we have identified from our audit.

## The scope of our work

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

We described the scope of our work in our audit plan.

## Use of this report

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

## What we don't report

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

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

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

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



**Pat Kenny, CPFA**

**For and on behalf of Deloitte LLP**

Glasgow | 16 September 2022

# Appendices



# Audit Adjustments

## Unadjusted misstatements

The following uncorrected misstatements have been identified up to the date of this report. The overall impact on the Statement of Charitable Activities and Net Assets is £0.228m

	Debit/(Credit) SOFA £m	Debit/(Credit) in Net Assets £m	Debit/(Credit) prior year Taxpayer's Equity £m	Debit/(Credit) in Income £m
<b>Misstatements identified in current year</b>				
Accruals judgemental [1]	0.331	(0.331)	-	-
Grant liability judgemental [2]	(0.103)	0.103	-	-
<b>Total</b>	<b>0.228</b>	<b>(0.228)</b>	-	-

[1] During our accruals testing we have identified a factual error (see page 32) given the error identified we have extrapolated the error rate across the remaining population not subject to audit testing. This is a judgemental error and therefore management have retained this as an uncorrected error.

[2] During our grant liabilities testing we have identified a factual error (see page 32) given the error identified we have extrapolated the error rate across the remaining population not subject to audit testing. This is a judgemental error and therefore management have retained this as an uncorrected error.

# Audit Adjustments (continued)

## Corrected misstatements

The following misstatements have been identified up to the date of this report which have been corrected by management. We nonetheless communicate them to you to assist you in fulfilling your governance responsibilities, including reviewing the effectiveness of the system of internal control.

		Debit/(credit) SoFA £m	Debit/(credit) in net assets £m	Debit/(credit) prior year Funds £m	Debit/(credit) OCI/Funds £m
Classification of HMRC Gift Aid Payment	[1]	-	-	-	-
Classification of VAT balance	[2]	-	-	-	-
Accruals	[3]	0.099	(0.099)	-	-
Grant Liabilities	[4]	(0.418)	0.418		
<b>Total</b>		<b>(0.319)</b>	<b>0.319</b>		

[1] We identified that a payment for £330k relating to Gift Aid due from Q4 2021/22 had been classified as accrued income, whereas it should have been classified as an 'Other Debtor'. The error had no net impact on the balance sheet, being a classification error between two current assets, and has been corrected by Management.

[2] During the audit we identified a debit balance for VAT that was incorrectly classified within creditors of £448k. Management have agreed that this should be reclassified into VAT within the debtors balance and corrected the misstatement. This is a reclassification within the balance sheet only and does not affect the surplus for the year.

[3] During the audit we identified differences in the accruals selected for testing as well as management identifying an additional accrual for utilities. The error which has been corrected by management is the factual element.

[4] During the audit we identified differences in the grants samples selected for testing in particular where a liability remained but the grant had finished. Management have corrected this factual element.



# Action Plan

## Recommendations for improvement

No.	Area	Recommendation	Management Response	Responsible person	Target Date	Priority
1	National Fraud Initiative	In line with the Audit Scotland report published on the 2018/19 exercise, we would encourage the ARAC and staff leading the NFI work review the NFI self appraisal checklist for future exercises.	Agreed	Head of finance	March 2023	Low
2	Classification of assets and liabilities	Deloitte noted an improvement in the financial statements compared to the prior year audit and note that management did implement a defined programme of review. Management should ensure that this review includes the classification of assets and liabilities within the appropriate notes in future years based on the latest information available.	Checks on assets and liability classification will be build into the accounts preparation and review process.	Head of Finance	June 2023	Low
3	Grants Process	We recommend that the grants process is reviewed in its entirety to reduce manual intervention, promote accuracy and improve efficiency.	The use of the new grants management system, which should be active for all new grants schemes by the end of the financial year, will help with this automation process. And we are looking to automate the grant reconciliation process as far as possible this year to mitigate against manual errors.	Head of Grants and Head of Finance	June 2023	Medium

# Action Plan

We have followed up the recommendations made in our previous years audits. We are pleased to note that five recommendations have been fully implemented, one recommendation is partially implemented ahead of target date and one not yet implemented.

Recommendation	Management Response	Priority	Management update 2021/22
<p><b>1 Financial Management</b></p> <p>Future savings plans, particularly in the medium to longer term, should be clearly linked to service reviews and workforce plans. (As initially planned as part of the 2019 Financial Strategy).</p>	<p>The financial strategy will be refreshed in 21/22 and consideration will be given to the need for savings plans linked to service reviews. Any requirement will be reflected in the action plan linked to the strategy.</p> <p><b>Responsible Person:</b> Head of Financial Business Support</p> <p><b>Target Date:</b> March 2022</p>	Medium	<p>Due to the timing of the SG Resource Spending Review the refresh of the Financial Strategy has been delayed to take account of the outcomes of the Spending Review. HES is currently completing a business model review and will consider the financial strategy alongside that.</p> <p><b>Not Implemented</b></p> <p>Revised Target date: March 2023</p>
<p><b>2 Financial sustainability</b></p> <p>The budget should make explicit links to the Corporate Plan and the outcomes the budget expects to progress with the resources expended, in order to enable the Committee to scrutinise whether the focus being placed on the Board's priorities is appropriately resourced. (As initially planned as part of the 2019 Financial Strategy)</p>	<p>The budget development for 22/23 will link activities to corporate plan outcomes and the level of resource committed to each of the outcomes will be presented as part of the budget paper approved by the Board. In addition specific costs associated with Annual Operating Plan measures will be highlighted in the budget paper.</p> <p><b>Responsible Person:</b> Head of Financial Business Support</p> <p><b>Target Date:</b> March 2022</p>	Medium	<p>Budget submissions from Directorates are linked to corporate outcomes. Whilst the 22/23 budget has been approved by the Board at a high level, a more detailed Directorate split will be taken for approval in April 22 which will include a split by outcome.</p> <p><b>Fully Implemented</b></p>

# Action Plan (continued)

Recommendation	Management Response	Priority	Management update 2021/22
<p><b>3 Governance &amp; Transparency</b></p> <p>HES should review its approach to openness and transparency including: the publication of information, use closed sessions of Board meetings and public Board meetings.</p>	<p>Management will work with the new Chair of the Board, when appointed, to consider and take forward this recommendation.</p> <p><b>Responsible Person:</b> Head of Chief Executive's Office</p> <p><b>Target Date:</b> December 2022</p>	<p>Medium</p>	<p>HES now has a new Chair in place and we can confirm that since his appointment no closed sessions have occurred and there is no proposal to hold so in the future.</p> <p>Consideration has been given to publishing papers along with minutes, however, the preference is to continue to publish minutes only.</p> <p><b>Fully implemented</b></p>
<p><b>4 Value for Money</b></p> <p>HES should review its performance management assessment process to consider how the impact of actions can be measured. Consideration should also be given to having an independent review of the self-assessment process, for example through a peer review.</p>	<p>The performance management assessment process will be reviewed to consider how the impact of actions can be measured and we will consider having an independent assessment of the self-assessment process after the end of the current Corporate Plan period and as part of the next full review of the Corporate Plan.</p> <p><b>Responsible Person:</b> Head of Corporate Analysis and Performance</p> <p><b>Target Date:</b> March 2023</p>	<p>Medium</p>	<p>Performance assessment process reviewed for 2022-23 Annual Operating Plan. Where possible, success measures have been upgraded. However, further work will be needed to move to an impact measurement framework and this is planned to take place during 2022-23.</p> <p>Initial discussions held with potential peer organisation and terms of reference for review under development.</p> <p><b>Partially Implemented(not yet due)</b></p>

# Action Plan (continued)

Recommendation	Management Response	Priority	Management update 2021/22
<p><b>5 Management Review</b></p> <p>Management should enhance and document their review of key supporting working papers and the draft Annual Report and Accounts prior to their submission to audit.</p>	<p>The number of challenges we faced with the 2020-21 Annual Report and Accounts including the introduction of a new Finance system and continued impact of COVID-19 limited our ability to complete an effective management review. Our plans for the preparation of the 2021-22 Annual Report and Report will build into sufficient time for an enhanced and documented review.</p> <p><b>Responsible Person:</b> Head of Finance</p> <p><b>Target Date:</b> Dependant on 2021/22 audit timetable</p>	<p>Medium</p>	<p>The prudent timetable for preparation of the 2021-22 annual accounts allowed for extensive period of time for management review, and all key supporting working papers and audit deliverables were subject to management review.</p> <p><b>Fully implemented</b></p>
<p><b>6 'After Action Review'</b></p> <p>Given the issues identified during the audit, HES should undertake an 'after action review' to identify lessons learned to improve the Annual Report and Accounts and audit process in future years.</p>	<p>Fundamentally, most of the issues with the 2020-21 Annual Report and Accounts were a result of a move to new finance system in the middle of the year and this will not be repeated. But we will undertake a 'lessons learned' review to inform our planning for the 2021-22 Annual Report and Accounts.</p> <p><b>Responsible Person:</b> Head of Finance</p> <p><b>Target Date:</b> March 2022</p>	<p>Medium</p>	<p>A 'lessons learned' review was undertaken with those involved in the accounts preparation and audit, including the external auditors. Improvements around planning, communication, clarification of roles and responsibilities, and quality of information provided to audit were identified and implemented for the 2021-22 accounts preparation and audit.</p> <p><b>Fully implemented</b></p>

# Action Plan (continued)

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Recommendation	Management Response	Priority	Management update 2021/22
<p><b>7 Reconciliations</b> A number of audit adjustments identified occurred due to full reconciliations not being performed (for example, grant accruals and intercompany transactions), primarily as a result of changes to the system and competing priorities. HES should ensure that appropriate reconciliations and preparatory work are carried out and reviewed prior to preparation of the draft Annual Report and Accounts.</p> <p>To achieve this, there may be a need to consider the Annual Report and Accounts and audit timeline to ensure sufficient time is available for HES to perform the necessary procedures.</p>	<p>Management accept and agree with this recommendation.</p> <p><b>Responsible Person:</b> Head of Finance</p> <p><b>Target Date:</b> April 2022</p>	<p>Medium</p>	<p>The prudent timetable for preparation of the 2021-22 annual account allows for more than sufficient time to complete reconciliations, preparatory work and review before the audit started.</p> <p><b>Fully implemented</b></p>

# Our Other Responsibilities Explained

## Fraud responsibilities and representations



### Responsibilities:

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



### Required representations:

We have asked the Board to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you have disclosed to us all information in relation to fraud or suspected fraud that you are aware of and that affects the entity or group.

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



### Audit work performed:

In our planning we identified the risk of fraud in relation to completeness of commercial income and management override of controls as a key audit risk for your organisation.

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

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

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

# Independence and Fees

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

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## Independence confirmation

We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Board and our objectivity is not compromised.

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## Fees

The audit fee for 2021/22, in line with the expected 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	<b>81,630</b>

The misstatements within grant liabilities meant additional work undertaken, we are therefore discussing an additional fee with management.

No non-audit services fees have been charged for the period.

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## 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.

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## Relationships

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

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





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