

A REPORT BY THE AUDITOR GENERAL FOR SCOTLAND UNDER SECTION 22(3) OF THE  
PUBLIC FINANCE AND ACCOUNTABILITY (SCOTLAND) ACT 2000

**THE 2005/2006 AUDIT OF SCOTTISH ENTERPRISE**

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1. I have received the audited accounts of Scottish Enterprise for the year ended 31 March 2006. The auditor's report on the accounts is not qualified but I have decided to issue this report to bring to the Parliament's attention Scottish Enterprise's financial position.
2. I submit these accounts and the auditor's report in terms of sub-section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report which I have prepared under sub-section 22(3) of the Act.
3. Scottish Enterprise is a non-departmental public body sponsored by the Scottish Executive Enterprise, Transport and Lifelong Learning Department (SEETLLD). Its remit is to further the development of Scotland's economy; enhance skills and capacities relevant to employment in Scotland; promote industrial efficiency and international competitiveness; and further improve the environment of Scotland.
4. Resource accounting and budgeting (RAB) is the application of accruals accounting to the expenditure, budgeting and reporting of central government and its agencies. During 2005/2006, SEETLLD provided Scottish Enterprise with a resource budget of £454 million including £9.6 million to cover non-cash costs such as depreciation, asset impairment, capital charges and provisions. Scottish Enterprise has, however, reported an overspend of £33 million against their overall resource budget for the year. This consisted of an excess against resource budget of £6 million for cash and £27 million for non-cash costs.
5. The overspend has occurred during a year when a new planning and resource allocation model was introduced to replace the existing budgetary control framework. The main feature of this model was that local enterprise companies and business units were no longer given annual budgets but were encouraged to deliver more projects within a framework of quarterly forecasting. The intention of the model was that it would encourage a strong pipeline of projects, address a historic pattern of annual underspends and reduce peaks in year-end spend and activity.
6. Internal and external investigations have been undertaken into the overspend position, including a report by the Scottish Parliament's Enterprise and Culture Committee. The main contributing factors to the overspend position were identified as: a failure to address an historic shortfall in non-cash cover within the resource budget; this shortfall was not factored into the resource allocation model, and therefore total resources available for investment during the year were overstated; the complexity of the application of RAB to the organisation's key activities of economic growth and investment; the absence of a training programme for managers to help them understand the RAB consequences of major investment decisions; the introduction of the new resource allocation model without sufficient controls in place to support this; the absence of a system for strategic prioritisation of projects; a lack of clear responsibility and accountability for the model; and a failure by Scottish Enterprise to act on early financial forecasts which projected an overspend.
7. On 30 March 2006 the Deputy First Minister made a statement to Parliament confirming that Scottish Enterprise could draw £30 million of resource from the 2006/2007 budget to cover this year's overspend. This additional allocation was based on a best estimate of the likely outturn position at that time and included an additional £25 million non-cash budget from SEETLLD and approval for Scottish Enterprise to use £5 million of its accumulated reserves. Scottish Ministers have now set a resource budget for Scottish Enterprise of

£467 million for 2006/2007. This consists of £412 million cash, cover of £20 million to utilise existing reserves and a non cash budget of £35 million. The new non-cash budget represents a significant increase from the existing allocation of £9.6 million which is now widely recognised to be have been insufficient.

8. Scottish Enterprise has now finalised its financial and operating plans for 2006/2007. The Operating Plan includes a reduction in planned resources as a consequence of the extra cover provided in 2005/2006. The 2006/2007 Operating Plan budgets for expenditure, including non-cash costs, of £550 million. In addition, approximately £4.6 million of legal commitments are not currently included in the Plan. Scottish Enterprise intends to manage this position through the re-phasing of projects to meet RAB targets for the current year.
9. A consolidated action plan has been prepared summarising the recommendations from each of the investigations into the current overspend position, and the action that Scottish Enterprise is taking in response to these recommendations. Given the importance of these issues to Scottish Enterprise I shall expect the appointed auditor to monitor progress against this action plan and report to me as necessary.



**ROBERT W BLACK**  
**Auditor General for Scotland**  
**24 August 2006**