# Scottish Enterprise

## Annual report on the 2011/12 audit

AUDIT SCOTLAND

Prepared for Scottish Enterprise and the Auditor General for Scotland

August 2012

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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# Key messages

## 2011/12

We have given an unqualified opinion that the financial statements of Scottish Enterprise for 2011/12 give a true and fair view of the state of the body's affairs and of its net expenditure for the year.

The 2011/12 financial statements include voluntary severance costs of £1.7 million. As part of our audit review of regularity of expenditure and income, we considered specific issues of compliance with the terms and conditions identified in the Scottish Government's approval for the voluntary severance programme. We concluded that the conditions had been met, however our review highlighted that governance and process improvements should be made. These improvements include a review of the existing Scottish Enterprise Selective Voluntary Severance terms, documented evidence of Executive Leadership Team approval and the robustness of evidence to support the judgements made.

Overall the system of internal control and arrangements for the prevention and detection of fraud were satisfactory during 2011/12. However there were a number of issues that were identified during the year including:

- the deletion of a large volume of operational electronic data by the third party IT provider
- the misuse of public funds by a senior member of staff in a subsidiary company
- a fraudulent change of supplier bank details request which was processed due to a key control not being implemented.

We note that the number of issues may not be typical of an individual financial year and confirm that appropriate actions have been taken by management in each case. We will continue to monitor related developments of the control framework.

## Outlook

We confirm the financial sustainability of Scottish Enterprise on the basis of its financial position and projected three-year financial summary based on a stable grant-in-aid provision (in line with the 2012/13 allocation) and property and investment fund income. We recognise that some of the income streams, representing around 16% of funding, may be challenging to sustain - particularly property disposals.

# Introduction

1. This report is the summary of our findings arising from the 2011/12 audit of Scottish Enterprise. The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, and to summarise the auditor's opinions (on the financial statements) and any significant issues identified. The report is divided into sections which reflect the extent of our public sector audit model.

2. Reports have been issued in the course of the year in which we make recommendations for improvements (Appendix A). We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of Scottish Enterprise.

3. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that Scottish Enterprise understands its risks and has arrangements in place to manage these risks. The Board and Accountable Officer should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.

4. This report is addressed to Scottish Enterprise and the Auditor General and should form a key part of discussions with audit committees, either prior to or as soon as possible after the formal completion of the audit of the financial statements. Reports should be available to the Scottish Parliament, other stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.

5. This report will be published on our website after consideration by the Audit Committee.

6. The management of Scottish Enterprise is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified are only those which have come to our attention during our normal audit work, and may not be all that exist. Communication of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

# Financial statements

7. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.

8. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
   - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
   - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
   - the regularity of the expenditure and income.

9. Auditors review and report on, as appropriate, other information published with the financial statements, including the management commentary, remuneration report and governance statement. Where required, auditors also review and report on the whole of government accounts return. This section summarises the results of our audit on the financial statements.

## Audit opinion

10. We have given an unqualified opinion that the financial statements of Scottish Enterprise for 2011/12 give a true and fair view of the state of the body's affairs and of its net expenditure for the year.

### Regularity

11. In accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000, we have also provided an opinion, that in all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance issued by Scottish Ministers.

12. As part of our audit review of regularity, we considered specific issues of compliance with the terms and conditions identified in the Scottish Government's approval of the voluntary severance programme. We concluded that the conditions had been met, however our review highlighted governance and process improvements that should be made and these are detailed in paragraphs 65 to 73.

### Governance statement and remuneration report

13. 2011/12 is the first year that Scottish Enterprise has been required to include a governance statement, rather than a statement on internal control, within the financial statements. We have reviewed the governance statement and confirmed that it complies with the guidance from Scottish Ministers.

14. We have also reviewed the part of the remuneration report subject to audit and concluded that it has been properly prepared and is consistent with the other information contained within the financial statements.

## Accounting issues

15. Scottish Enterprise is required to follow the 2011/12 Government Financial Reporting Manual (the FReM) and we confirm that the financial statements have been properly prepared in accordance with the FReM.

### Accounts submission

16. The accounts were submitted promptly and the audit delivered within four weeks. The full consolidated (group) financial statements and narrative disclosures were provided on 1 June 2012. The working papers were of a high standard and the staff provided good support to the audit team enabling all outstanding points to be cleared and fully revised financial statements were provided on 19 June 2012.

17. A report covering the key matters arising from the financial statements audit (the ISA260 report) was issued on 21 June 2012 and presented to the Audit Committee on 28 June 2012. The financial statements were signed by the Accountable Officer on 29 June 2012 following Board approval.

### Presentational and monetary adjustments to the unaudited accounts

18. A small number of presentational changes were required to the annual report and accounts as a result of our review of the disclosures required by the FReM. We also identified some monetary changes including:

- net operating expenditure of the Group increased by £2 million as a result of the change in accounting treatment detailed in paragraph 21 below
- classification changes in the statement of financial position between short term and long term payables (£5 million), receivables (£1 million) and investments (£4 million).

19. All errors identified during the audit were corrected in the financial statements.

### Prior year adjustments

20. The 2011/12 FReM withdrew the option to offset European funding for investment purposes against the cost of investments made by Scottish Enterprise. This funding is now regarded as income in the year in which the associated investment is made. A prior year adjustment was therefore necessary in the financial statements. This change resulted in additional income of £8 million and an increase in the value of investments recognised in the statement of financial position of £47 million.

21. The 2011/12 FReM also removed the option to defer capital grant income, used to finance the cost of assets, unless there are unmet conditions imposed by the funder. This resulted in additional consolidation adjustments in the group financial statements, for a limited number of

assets held by subsidiaries. As a release of grant funding is no longer available to mitigate the depreciation charge, expenditure in the group statement of comprehensive net expenditure has increased by £2 million. The deferred income balance has now been eliminated from the prior year.

### Group arrangements

22. Scottish Enterprise has a complex group structure. The 2011/12 financial statements require the consolidation of 40 subsidiaries and 15 equity accounted investees, although some entities are currently dormant. On 29 March 2012, the Local Enterprise Companies agreed to transfer their remaining property interests, shares and loans to Scottish Enterprise for no consideration. Audit testing confirmed that this process was correctly accounted for within the financial statements. Due to outstanding financial and legal matters a small number of financial assets, with a value of £10 million, are still retained by the Local Enterprise Companies.

23. The audits of the subsidiary companies were completed in accordance with the agreed timetable by KPMG LLP (the auditor to the subsidiary bodies) to enable Scottish Enterprise to consolidate the results into the financial statements and all received an unqualified audit opinion. Key policies for component bodies such as the valuation of non-current assets, have been aligned to those of Scottish Enterprise. Some of the equity accounted investees have different financial year ends and appropriate adjustments have been made to ensure they are correctly consolidated.

### Whole of Government Accounts

24. The whole of government accounts (WGA) is the consolidated financial statements for all branches of government in the UK. The aims of WGA are to provide improved data for fiscal planning, increase transparency and improve accountability to Parliament. Scottish Enterprise is required to submit a consolidation pack to the Scottish Government and appointed auditors by 31 July 2012. The audit deadline is 24 August 2012. The WGA return was submitted by Scottish Enterprise and audited by us in accordance with these deadlines.

## Outlook

### Sustainability Reporting

25. From 2011/12, all relevant bodies were encouraged to produce a sustainability report in accordance with the Scottish Government's Public Sector Sustainability Reporting Guidance (January 2012). This guidance is non-mandatory, however it represents good practice and central government bodies were encouraged to adhere to it. The sustainability report should contain:

- a simple overview commentary covering a body’s performance in the reported year along with an overview of forward plans

- a table of financial and non-financial information covering the body's emissions, waste, water and any other finite-resource consumption for the financial year to which it relates.

**26.** Public bodies in Scotland are bound by the Climate Change Public Bodies Duties set out in Part 4 of the Climate Change (Scotland) Act 2009. Whilst the Act does not require reporting on the duties, the Public Bodies Duties Guidance encourages a voluntary approach to reporting. For 2011/12 Scottish Enterprise has produced a separate sustainability report which will be presented to the Executive Leadership Team for approval in late July 2012. As this report was not included as part of the Annual Report and Accounts it is not covered by the consistency element of our audit opinion.

# Financial position

27. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.

28. Auditors consider whether audited bodies have established adequate arrangements and examine:

- financial performance in the period under audit
- compliance with any statutory financial requirements and financial targets
- ability to meet known or contingent, statutory and other financial obligations
- responses to developments which may have an impact on the financial position
- financial plans for future periods.

29. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

## Financial results

30. The main financial objective for Scottish Enterprise is to ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers. Scottish Enterprise operated within the resource budgets for 2011/12 as detailed in Table 1 below which also shows the budget changes that occurred during the financial year.

**Table 1: Resource Budget**

| | Initial Budget (£'000) | Autumn Revision (£'000) | Spring Revision (£'000) | Final Budget (£'000) | Actual Outturn (£'000) | Under / (Over) spend |
|---|---|---|---|---|---|---|
| Resource DEL | 160,157 | 3,220 | 2,621 | **165,998** | - | |
| Capital DEL | 34,200 | - | (100) | **34,100** | - | |
| Regional Selective Assistance | - | 45,190 | - | **45,190** | - | |
| **Total (Grant in aid)** | **194,357** | **48,410** | **2,521** | **245,288** | **244,389** | **899** |
| Non Cash DEL | 27,772 | - | - | **27,772** | **5,423** | **22,349** |
| AME | - | - | 23,300[1] | **23,300** | **17,459** | **5,841** |

*Source: Finance and Performance Reports:*

31. The budget revisions resulted in additional in-year budget increases of £26 million. The significant under-utilisation of the non-cash DEL budget (departmental expenditure limit) is

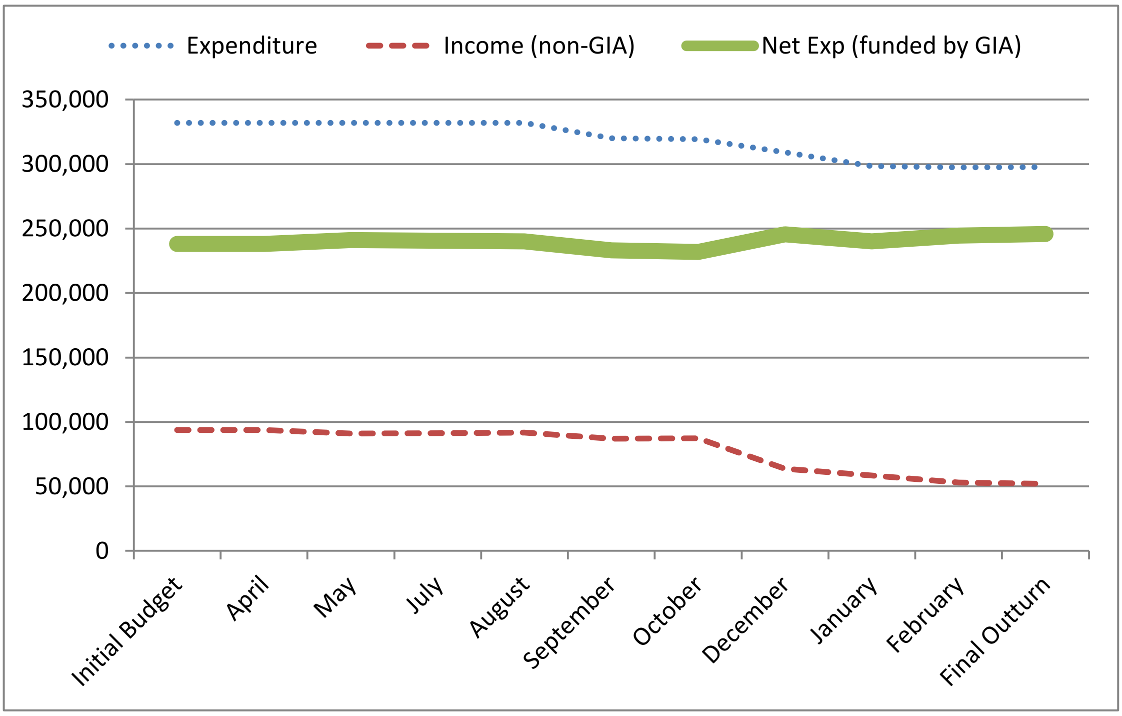
[1] not shown in the spring Budget Revision as scores against HM Treasury Budget

due to Scottish Enterprise being awarded an AME (annually managed expenditure) allocation for the first time during 2011/12, as an additional budget, which enabled expenditure that might previously be charged against non-cash DEL to be treated as AME.

## Budgetary control

32. Finance and Performance Reports are presented to each Board meeting providing details of the financial results for the period and the forecast outturn for the financial year. The budget reporting throughout the year presented an accurate forecast of the year end financial outturn against Grant in Aid, as indicated in Exhibit 1 with the final net expenditure position increasing only 3% from the initial budget.

### Exhibit 1: Financial Reporting




*Source: Finance and Performance Reports*

33. In September 2011 the Board was asked to approve a re-baselined budget based on the financial results of the year-to-date. This resulted in expenditure and the associated income being reduced by £12 million due to delays in a range of projects. Where appropriate, the balances on these projects were re-profiled into future years. In December 2011 additional reductions were forecast across a number of areas including Scottish Loan Fund (£2 million), Scottish Co-Investment Fund (£1 million) and a range of projects within Business Infrastructure (£2 million). The income forecast was also reduced further, primarily for the property disposal income (£15 million) reduction as a result of a further assessment of the market conditions.

# Financial position

34. On the basis of the information in this section of the report, we have concluded that subject to any major change in investment and pension valuations or Scottish Government funding, the financial position of Scottish Enterprise is stable and its activities are financially sustainable, The continuing assumption of significant property disposal income (of £20 million each year) in Scottish Enterprise's financial plans is challenging in the current property market. Scottish Enterprise is planning to address the gap in the 2012/13 projected outturn through a mid-year rebasing of budgets. This process is consistent with last year.

35. The most significant changes within the statement of financial position are described in the paragraphs that follow. Overall the total equity of Scottish Enterprise increased by £48 million during the year. There were two main reasons for this change: an increase in the value of investments of £36 million (short and long term) and an increase in the pension asset of £22 million. Both of these areas are subject to annual valuation exercises.

## Investments and cash balances

36. As at 31 March 2012 the Scottish Enterprise group held investments of £139 million, an increase of £33 million from the prior year. The movement primarily relates to additional in-year investments of £31 million across a large number of bodies. The majority of the investments are held in available-for-sale financial assets. The impact of the revaluation process was a £2 million increase (after impairments).

37. The cash and cash equivalents held by the group at 31 March 2012 are £93 million, with £61 million of this total related to the Scottish Co-Investment Fund and the Scottish Loan Fund. These balances cannot be applied to fund any other activity.

## Pension asset

38. Scottish Enterprise employees are members of the Scottish Enterprise Pension & Life Assurance Scheme which is a defined benefit scheme. A full actuarial valuation was carried out using membership data as at 31 March 2011 and the results of that valuation have been projected to 31 March 2012. The financial statements include a pension asset of £59 million (increased from £36 million last year).

39. This change is the cumulative effect of the increase in value of scheme assets and a reduction in pension obligations. The pension obligations have reduced due to the net effect of changes in actuarial assumptions. Increased liabilities from a reduction in the discount rate and changes in mortality assumptions have been offset by greater changes in the assumptions about long term salary growth and inflation.

# Capital investment 2011/12

40. During the year Scottish Enterprise spent £15 million on property, plant and equipment with the majority relating to expenditure on the Bio-incubator building at the Edinburgh Bioquarter which was completed and brought into operational use during 2011/12. Following completion

of this project, the asset was revalued resulting in an impairment adjustment of £7 million which was charged against the AME budget for the year.

## Financial planning to support priority setting and cost reductions

### 2012/13 budget and reporting

41. In February 2012 the Board approved a balanced budget for 2012/13 of £306 million (£332 million in 2011/12). The key areas of spending reduction are within the areas of Globally Competitive Business (£2 million reduction) and Globally Competitive Business Environment (£24 million). The expenditure will be funded by Grant in Aid (£231 million), EU funding (£11 million), property income (£30 million) and other income, including investment funds, (£34 million).

42. Recent financial reporting to the Board shows expenditure to the end of July 2012 of £62.3 million against a profile position of £70.4 million (88% of profile). However the full year forecast identifies a potential overspend of £6.2 million against the annual £306 million budget. The main reason for the projected outturn is the property disposal forecast has been revised downwards from £23 million to £3 million. A significant element of this, £12 million, relates to the planned disposal at West Mains in East Kilbride which is dependent on the successful outcome of a judicial appeal, but will now not be realised until 2013/14. A further downward adjustment of £8 million is attributed to the current state of the property market.

**Refer Action Plan no. 1**

### Partnership working

43. In the current economic climate the area of partnership working and shared services is increasing in importance and scrutiny. Scottish Enterprise already has a partnership arrangement in place with Skills Development Scotland for the provision of information services which are outsourced to ATOS.

44. Scottish Enterprise is also part of the Scottish Government Strategic Forum. The other members are Highlands and Islands Enterprise, Skills Development Scotland, VisitScotland and the Scottish Funding Council. A partners' efficiency programme has been established to produce proposals to identify and generate efficiency gains through the realignment or sharing of back office and corporate functions.

45. Seven projects have been approved each of which is sponsored and led by one of the five member organisations. Scottish Enterprise is leading on the premises project and the review of back office services which involves considering the finance function, human resources, legal service, internal audit provision and procurement. Internal audit recently completed a review of progress to date which noted good progress has been made, with baseline costs having been assessed and an agreed savings target of £5.5 million per annum. However the review noted that successful delivery of efficiency savings depends on the full co-operation of all partners and the importance of developing clear action plans with defined timescales.

**Refer Action Plan no. 2**

# Outlook

## Financial forecasts beyond 2012/13

46. The Business Plan 2012-15 contains a three year financial summary outlining the forecast expenditure across each key business area and the associated projected income as detailed in Table 2.

**Table 2: Financial Summary**

| | 2012/13 Indicative Resource Allocation £m | 2013/14 Indicative Resource Allocation £m | 2014/15 Indicative Resource Allocation £m |
|---|---|---|---|
| Globally Competitive Business | 137.0 | 139.3 | 135.0 |
| Globally Competitive Sectors | 22.8 | 23.0 | 23.1 |
| Globally Competitive Business Environment | 92.3 | 88.8 | 86.3 |
| Marketing, Research & Stakeholder Engagement | 8.6 | 7.8 | 7.7 |
| Running The Business | 45.4 | 43.2 | 41.2 |
| **Total** | **306.1** | **302.1** | **293.3** |
| **Funded by** | | | |
| Grant in Aid | 230.9 | 231.1 | 229.1 |
| EU Funds | 11.0 | 9.0 | 7.0 |
| Property Disposals | 23.0 | 21.8 | 18.0 |
| Property Income | 7.0 | 6.0 | 5.0 |
| Co-Investment Fund | 10.0 | 12.0 | 12.0 |
| Scottish Loan Fund | 10.0 | 10.0 | 10.0 |
| Other Business Income | 14.2 | 12.2 | 12.2 |
| **Total** | **306.1** | **302.1** | **293.3** |

*Source: Scottish Enterprise Business Plan 2012-15*

47. These financial plans are based on a stable Grant in Aid provision in line with the 2012/13 allocation and significant property and investment fund income. Sources of income, other than Grant in Aid and investment fund income, represents approximately 16% of total income over the life of the plan and Scottish Enterprise recognises the risk that accompanies these sources of income and the importance of robust financial management arrangements.

# Governance and accountability

48. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.

49. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

50. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:

- corporate governance and systems of internal control
- the prevention and detection of fraud and irregularity
- standards of conduct and arrangements for the prevention and detection of corruption.

## Corporate governance

### Overall summary

51. The following paragraphs identify areas for improvement in some aspects of the corporate governance and internal control arrangements, but with the exception of these issues we found the overall arrangements to be satisfactory.

### Processes and committees

52. The Board is responsible for ensuring that Scottish Enterprise fulfils the aims and objectives set out by the Scottish Government in its Economic Strategy. The role of the Board includes establishing the overall strategic direction, monitoring performance against agreed objectives and ensuring that statutory requirements for the use of public funds are complied with. The Board is supported by six sub-committees with key areas of expertise and responsibility.

53. In September 2010 Audit Scotland published a report on *"The role of boards"*. The report examined the system of accountability within Scottish public bodies and colleges, the public appointments system and the performance of boards. The report included a list of questions for board members to use as a self-assessment tool. The Audit Scotland report was presented to Scottish Enterprise's board meeting in October 2010.

54. During 2011/12 we followed-up this report within Scottish Enterprise and assessed the progress made to improve the performance and operation of the board.

55. The original report highlighted that a key role for the board was to scrutinise risk. In response, the board have introduced a standing item at every second meeting to discuss the current key risks facing Scottish Enterprise to improve the strategic scrutiny of key risk areas.

56. Steps have also been taken to improve the effectiveness of the board's scrutiny of the regular reporting of corporate performance, financial management and risk management. The board requested more detailed information about the risks being faced and any areas of slippage. In February 2012 the format of the board's agenda also changed to include a new standing item to allow the chairs of each of the board committees to give verbal feedback on the issues they want to bring to the board's attention.

57. The report found that four-fifths of public sector organisations made board papers publicly available - three-tenths on their website and half on request. However, a fifth did not make board papers available - and recommends that public bodies should maximise the openness and accessibility of their board meetings and papers.

58. Scottish Enterprise board minutes are currently available on the website, however the meetings are held in private and no papers are available to the public, other than through freedom of information requests. Based on past annual public meetings and the experiences of other public bodies who have made board meetings open to the public, Scottish Enterprise is of the opinion that this is not effective and an unnecessary expense. However it is our view that further consideration should be given to publishing board papers, which are not commercially sensitive, on the website.

**Refer Action Plan no. 3**

## Internal control

59. While we concentrate on significant systems and key controls in support of the opinion on the financial statements, our wider responsibilities require us to consider the financial systems and controls as a whole. However, the extent of this work is informed by our assessment of risk and the activities of internal audit.

60. The key controls within financial systems should operate effectively to accurately record transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. As part of our audit we reviewed the high level controls operating and concluded that overall the system of internal control was operating effectively. The review identified a small number of areas where controls could be strengthened and these were reported to management in March 2012. We adjusted our financial statements approach to ensure appropriate coverage of these areas and no further issues were identified.

61. A key element of our work on internal controls is the extent of reliance that we can place on the work of internal audit. Our review established that the work of internal audit is of a good quality allowing us to place reliance on a number of areas including regional selective assistance, investments, infrastructure / property portfolio, subsidiaries, procurement and key

project controls. This not only avoided duplication of effort but also enabled us to focus on other key risk areas.

## Use of government procurement cards and other credit cards

62. Across the public sector government procurement cards have been used to reduce the costs relating to the purchase of small items and some internet based purchases where a credit card is the most effective way of making payment. A recent significant fraud, in another public body, which in part resulted from misuse of the government procurement card highlighted that bodies need to ensure that their processes for the use of these cards are fit for purpose.

63. Scottish Enterprise currently operates 70 government procurement cards, 54 centrally settled credit cards and 102 individually settled credit cards. Total expenditure processed through these arrangements is £1.6 million per annum. The government procurement cards are generally used for low value goods and services which are not covered by the purchase order processing arrangements already in place. Credit cards are used by UK and overseas staff to pay for expenses incurred in undertaking their job with a large proportion of the expenditure relating to travel costs.

64. There are policies and guides in place for each of the cards and internal audit undertook a review of credit card arrangements in March 2012. The review found no evidence of fraudulent activity or irregular payments but did identify cases of non-compliance with the policies in place. There was no financial loss to Scottish Enterprise as the credit cards were settled by the individuals, however recommendations have been made by internal audit to improve processes and strengthen the controls in place.

## Voluntary severance scheme

65. On 21 November 2011 Scottish Enterprise obtained approval from the Scottish Government to offer a Selective Voluntary Severance (SVS) programme. During 2011/12 eighteen staff agreed to leave Scottish Enterprise under this programme at a total cost of £1.7 million.

66. Scottish Enterprise used the 2011/12 SVS scheme in a targeted way and therefore did not formally communicate the scheme to all staff or update their policy, which dates from 2009 and is available to all staff via the intranet. The Scottish Government (SG) approval for the SVS scheme, in November 2011, recognised that the Scottish Public Finance Manual provides guidance that "the benefit structure and terms of compensation schemes for severance, early retirement or redundancy provided by SG sponsored bodies … should be broadly similar to the arrangements in place within the core SG and set out in the Civil Service Compensation Scheme (CSCS)". It also recognised that the SPFM specifically provides that "nothing in this guidance overrides the requirements of extant law" and that any programme should "consider the interaction of any new proposals with existing contractual terms... "

67. It was noted that in some circumstances the compensation payable under the terms of Scottish Enterprise's contractual severance scheme were now more than that available under the recently revised Civil Service Compensation Scheme. As such, the scheme did not

currently meet all of the guidance set out in the revised SPFM. However the Scottish Government was prepared to, and did, approve the proposed scheme on this occasion.

68. The SG approval also noted that for Future Severance Schemes Scottish Enterprise should make efforts, through its normal staff engagement process, to review the terms of its compensation schemes for severance, early retirement and redundancy so as to meet the guidelines in the SPFM. In doing so, it was accepted that Scottish Enterprise will need to consider the interaction of any new proposals with existing contractual terms. The expectation will now be that no approval will be given for any future scheme until that review is complete.

**Refer Action Plan no. 4**

69. The Scottish Government approval required all severances to be approved by the Executive Leadership Team (ELT) and subject to scrutiny by internal audit, external audit and the Remuneration Committee. Audit investigation confirmed that individual SVS cases were approved by a member of the ELT. During further discussions with officers we were informed that the following process was adopted:

- individual members of the ELT considered applications for severance in their business area against the conditions contained in the Scottish Government approval
- potential cases were then considered jointly by the People Services Director and the relevant ELT member in terms of value to the public purse
- the ELT received regular verbal progress updates on the severance scheme from the People Services Director.

70. We also sought evidence of the best value assessment that had taken place at the time of approval. Limited documentation was initially provided to demonstrate the future savings and related costs and tended to demonstrate the achievement of best value at the programme level rather than of individual packages. For example, an internal e-mail to the ELT at the end of March identified an overall payback period of "less than 1 year", but without any individual detail.

71. As the audit progressed, we were provided with spreadsheet evidence to support the individual and overall severance decisions, on a financial basis. This evidence introduced some uncertainty around backfill costs or reinvestment costs, which we sought to clarify. We also considered that some of the financial assumptions were not robust, for example the 80% on-cost to gross salaries. Officers identified that this 80% adjustment represents not only employers superannuation and pension costs (which account for around a 30% on-cost), but overhead costs too.

72. We found that these issues weren't critical to the best value assessment and we were provided with revisions of the data that demonstrated reasonable payback periods, both at programme level (which we estimate at 1.6 years) and for individuals (we estimate typically between 0.6 and 5.5 years).

73. We concluded that the various conditions specified by the Scottish Government had been met, following clarification provided by the director of business in the Scottish Government on 13 August 2012. However our expectation is that decisions of this nature should be:

- explicitly recorded in ELT minutes
- supported by agenda papers detailing the items for decision
- supported by more robust financial analysis
- subject to Remuneration Committee scrutiny.

**Refer Action Plan no. 5**

### ICT data handling and security

74. From 1 April 2010 Scottish Enterprise outsourced its information services to a third party provider, ATOS. In January 2012 a large volume of operational data was deleted, by ATOS technicians, in error from the live Customer Relationship Management system in an attempt to clear disk space. On investigation it was discovered that the backup of the server had not operated correctly and therefore the data was not easily recoverable. Internal audit have subsequently completed a review and an agreed action plan is currently being implemented to manage the risks associated with the deletion, backup and recovery of data.

## Prevention and detection of fraud and irregularities

75. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Auditors review and report on these arrangements.

76. The overall arrangements for the prevention and detection of fraud are satisfactory although there have been some specific frauds which indicate that improvements could be made. Scottish Enterprise has a range of measures in place to prevent and detect fraud, including a fraud and irregularities response plan, a code of conduct for staff and a whistle-blowing policy. There are defined procedures for handling suspicions, allegations or evidence of fraud or other irregularities, including reporting to the fraud response group for investigation.

77. In April 2011 Scottish Enterprise assumed control of a company which had been operating since 2003. In July 2011 it was established that a senior member of staff in that company had misused public funds over a number of years through the use of a company credit card, taxi account, CHAPs payments and potentially an invalid invoice. The issues were identified once the member of staff left the entity. Internal audit subsequently completed a review of the arrangements and controls have now been strengthened to prevent any reoccurrence. The details have been provided to the Police, and the matter has been referred to the Procurator Fiscal. Scottish Enterprise's Audit Committee is to further consider the over-arching scrutiny arrangements for its subsidiary bodies in the autumn.

78. During April 2012 finance staff processed a supplier bank account change following receipt of a fraudulent letter purporting to be from a supplier. Two payments were made to the fraudulent bank account, one was stopped promptly preventing any loss and most of the other payment was recovered. Following the incident, it was identified that a key control, to telephone the

supplier for confirmation of changes to bank details, had not been performed. Scottish Enterprise has subsequently reviewed all bank change requests processed in 2011/12 and additional controls have been introduced to strengthen procedures.

### NFI in Scotland

79. Scottish Enterprise participates in the National Fraud Initiative in Scotland (NFI). This is a counter-fraud exercise that uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify circumstances (matches) that might suggest the existence of fraud or error. Where matches are identified, public bodies are required to investigate these matches and, if fraud or error has taken place, to stop payments and attempt to recover the amounts involved.

80. The most recent data matching exercise collected data from participants in October 2010 and identified 11 matches for Scottish Enterprise. These matches were investigated by internal audit and no instances of fraud were identified. The national findings of this exercise were published by Audit Scotland in May 2012. The report contains a self-appraisal checklist that all participants are recommended to use prior to the start of the 2012/13 exercise in October 2012.

## Standards of conduct and arrangements for the prevention/ detection of bribery and corruption

81. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place. We have concluded that the arrangements in Scottish Enterprise are satisfactory and we are not aware of any specific issues that we need to identify in this report.

# Best Value, use of resources and performance

82. Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value.

83. The Auditor General may require that auditors consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value.

84. As part of their statutory responsibilities, the Auditor General and the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:

- a performance audit which may result in the publication of a national report
- an examination of the implications of a particular topic or performance audit for an audited body at local level
- a review of a body's response to national recommendations.

85. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments.

86. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.

87. This section includes a commentary on the arrangements within Scottish Enterprise, notes any headline performance outcomes used by Scottish Enterprise and comments on any relevant national reports and the body's response to these.

## Management arrangements

### Best Value

88. The Scottish Government guidance for accountable officers on Best Value in Public Services requires a systematic approach to self-evaluation and continuous improvement. The guidance identifies the themes which an organisation needs to focus on in order to deliver the duty of best value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.

89. Scottish Enterprise are currently using Audit Scotland's best value toolkit on effective partnership working to review service delivery.

### Performance management

90. The Government Economic Strategy sets out high-level targets for increasing Scotland's sustainable economic growth. These targets helped to shape the performance measurement within Scottish Enterprise to ensure that resources contribute to the National Performance Framework.

91. Scottish Enterprise has a framework in place for monitoring and reporting performance. The framework uses high level objectives to identify priorities that can then be broken down into the specific activities and outputs that will be measured. These then feed into the outcomes and impacts for Scotland. The board receives a Finance and Performance Report at each meeting detailing the full year forecasts for each performance measure to enable monitoring throughout the year.

92. Internal audit recently completed a review of performance measurement and concluded that there were satisfactory arrangements in place.

## Overview of performance in 2011/12

### Performance measurement outcomes

93. Scottish Enterprise monitors performance against 15 published measures and associated sub-measures, however 2 targets are long term and are not due to be achieved until 2015.

94. During 2011/12 Scottish Enterprise achieved 12 of the 15 quantified performance targets including:

- additional companies achieving significant turnover growth from exporting up to 191 companies
- new companies entering into exporting
- additional turnover growth by account-managed firms up to £1.2 billion
- 5 new entrepreneurial companies achieving £5 million turnover after years of trading
- 31,609 tonnes of CO2 savings arising from support from Scottish Enterprise that improves productivity.

95. The performance targets that were not achieved included the amount of additional business research and development investment from Scottish Enterprise assisted projects. The target range for 2011/12 was £65 million to £75 million and the actual achieved was £56 million due to companies curtailing or deferring investments. In addition, two sub-level targets relating to the renewables sector were not achieved. These were: approval of £7 million of R&D and Innovation Grant awards against a target of £15 million to £25 million and securing 188 high value jobs from inward investments against a target of 450.

## National performance reports

96. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest are detailed in Exhibit 2.

**Exhibit 2: A selection of National performance reports 2011/12**

| | |
|---|---|
| • Scotland's public finances - Addressing the challenges (Aug 2011) | • The role of community planning partnerships in economic development (Nov 2011) |

*Source: www.audit-scotland.gov.uk*

### Scotland's public finances - addressing the challenges

97. The report highlights that all parts of the public sector have less to spend in 2011/12 than in 2010/11, although the level of budget reduction varies significantly with central government experiencing the biggest funding reduction of 12 per cent. Although most bodies were able to agree a balanced budget for 2011/12 the report highlights the risk that savings may not be realised and that unforeseen pressures may emerge which reduce the ability to generate future savings. The report also notes that public bodies are finding it difficult to plan beyond 2011/12 as they do not have a clear view of their future budgets. It highlights the importance of long-term financial sustainability when looking to reduce costs including consideration of key areas such as reducing workforce levels and identifying opportunities to share services.

98. The Audit Committee was provided with this report at the September 2011 meeting. The Business Plan 2012-15 contains a 3 year financial summary showing indicative resource allocation and associated spending plans. As noted in paragraph 44 Scottish Enterprise is working with its Strategic Forum Partners to identify and generate efficiencies through the realignment or sharing of back office and corporate functions.

### The role of community planning partnerships in economic development

99. The report details the important role that community planning partnerships have in planning and coordinating improvements to local economies and highlights the need for a more joined-up approach to achieve sustainable economic growth nationally. The reduction in ring-fenced funding and the current economic climate increase the need for community planning partnerships to deliver agreed outcomes and understand the financial pressures of partners. The report highlights that existing accountability arrangements should be used to hold all partners to account for their contribution in delivering the single outcome agreement priorities.

100. The board was provided with details of the report at the December 2011 meeting and the key recommendations were noted. Scottish Enterprise is using the best value toolkit on effective partnership working to review service delivery. This includes consideration of whether single outcome agreement commitments are appropriately reflected within Scottish Enterprise plans.

# Appendix A: audit reports

### External audit reports and audit opinions issued for 2011/12

| Title of report or opinion | Date of issue | Date presented to Audit Committee |
|---|---|---|
| Annual Audit Plan | 6 December 2011 | 14 December 2011 |
| Key financial controls assurance report | 13 March 2012 | 21 March 2012 |
| Report on financial statements to those charged with governance | 21 June 2012 | 28 June 2012 |
| Audit opinion on the 2011/12 financial statements | 21 June 2012 | 28 June 2012 |

# Appendix B: action plan

## Key Risk Areas and Planned Management Action

| Action Point | Refer Para No | Risk Identified | Planned Management Action | Responsible Officer | Target Date |
|---|---|---|---|---|---|
| 1 | 42 | The 2012/13 budget includes a recent reduction in the expected income from property sales of £20 million.  The forecast full-year out-turn is currently £6.2m in excess of budget of £306.2m<br>Risk - There is a risk of budget overspend at the year end due to reductions in property sales income. | In line with normal practice, the position will be actively managed to maintain a balanced budget position.  As in previous years, a proposal to re-baseline the business plan expenditure will be brought to the Board at the half-year stage. | Chief Financial Officer | 30 September 2012 |
| 2 | 45 | Scottish Enterprise is working with the Strategic Forum Partners to generate efficiency gains through the realignment or sharing of back office and corporate functions. An internal audit review identifies the importance of developing clear action plans with defined timescales.<br>Risk - The delivery of efficiency savings is not achieved. | Work is ongoing with partners to ensure full co-operation.<br>Action plans will be completed for the delivery of the identified efficiencies. | Chief Financial Officer | 31 March 2013 |

| Action Point | Refer Para No | Risk Identified | Planned Management Action | Responsible Officer | Target Date |
|---|---|---|---|---|---|
| 3 | 58 | Board meetings are held in private and papers are not available to the public.<br>Risk - A public perception develops that Scottish Enterprise is not sufficiently open and transparent. | Further consideration will be given to including board papers on the website. | Company Secretary | 31 December 2012 |
| 4 | 68 | The terms of the Scottish Enterprise SVS scheme exceed those available under the CSCS scheme.<br>Risk - Future approval by the Scottish Government may be subject to a review of the terms and conditions. | As agreed with the Scottish Government in November 2011, the terms of the SE compensation schemes will be reviewed prior to making proposals for approval of any future severance scheme | People Services Director | Prior to any future programme. There are currently no plans for any future programme. |
| 5 | 73 | The approval process for the 11/12 SVS scheme was not explicit nor supported by clear agenda papers and analysis.<br>Risk - SVS payments are made which are not explicitly approved and do not represent best value to the public purse. | The process and justification for individual approvals in any future scheme will be fully documented and any required approval by ELT will be explicitly recorded. | People Services Director | Prior to any future programme. There are currently no plans for any future programme. |