

Highlands and Islands Enterprise

Annual report on the 2012/13 audit



Prepared for Highlands and Islands Enterprise and the Auditor General for Scotland
November 2013

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

2012/13

We have given an unqualified audit report on the financial statements for 2012/13.

Highlands and Islands Enterprise operated within the resource budget set by the Scottish Government. In addition to original Grant in Aid of £48.4 million, during the year additional funding of £15.5 million was made available for specific shovel-ready and energy projects. This addressed the majority of the funding gap of £15.8 million identified in the original budget.

Previous audit issues on the accounting treatment of depreciation and revaluation of non-current assets have been largely addressed as a result of the 2012/13 audit and remedial action taken by officers. This included restating prior year comparatives. Further work will be required during 2013/14 to address a number of areas of accounting treatment which are not currently being carried out, in particular the review of useful lives of assets as part of the annual valuation process.

Outlook

The 2012/13 audit process highlighted some capacity issues in the finance team especially during the peak accounts preparation period. There are plans to review the resourcing and skills mix of the finance team to address this for the 2013/14 financial statements' audit.

The 2013/14 budget approved by the Board in April 2013 included planned expenditure of £9.3 million on a number of pipeline projects without allocated funding. Highlands and Islands Enterprise anticipate that the Scottish Government will make available shovel-ready funding which can be allocated to these projects or alternatively active financial management will be applied to address the shortfall.

In 2012/13 an allocation of shovel-ready funding of £2.7 million for Barmuckity Business Park could not be spent before the year end with the Scottish Government permitting this money to be used to pay-down year end creditors. There remains uncertainty about whether HIE will need to refund this project from within their existing resources in 2013/14, possibly by reducing the grant in aid drawdown from the Scottish Government. As this project continues to develop this approach could have an adverse effect on either the payment of creditors or on other potential project funding.

The pension liability in the statement of financial position has risen from £9.3 million to £25.6 million over the last three years with the last formal actuarial valuation at March 2012 showing a deficit of £27 million. A recovery plan was put in place in 2010 to address the funding position and to enable the scheme to meet the requirements of the Hutton review of public sector pensions. A revised recovery plan is currently being negotiated with staff and will include changes to employee contributions and the benefits paid from the scheme. Senior management are planning changes will be implemented in time for the April 2014 pay remit to the Scottish Government.

Introduction

1. This report is the summary of our findings arising from the 2012/13 audit of Highlands and Islands 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 (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.
2. A number of 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 Highlands and Islands 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 Highlands and Islands Enterprise understands its risks and has arrangements in place to manage these risks. The Accountable Officer and other members of the board 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 Highlands and Islands Enterprise and the Auditor General and should form a key part of discussions with the Risk and Assurance Committee, as soon as possible after the formal completion of the audit of the financial statements. Reports should be made available to 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 Risk and Assurance Committee.
6. The management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to our attention during our normal audit work, and may not be all that exist. Communication by auditors 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. We 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. We review and report on, as appropriate, other information published with the financial statements, including the management commentary, governance statement and the remuneration report. This section summarises the results of our audit on the financial statements.

Audit opinions

10. We have given an unqualified opinion that the financial statements of Highlands and Islands Enterprise for 2012/13 give a true and fair view of the state of the body's affairs and its net expenditure for the year.
11. HIE is required to follow the 2012/13 Government Financial Reporting Manual (the FReM) and we confirmed that the financial statements have been properly prepared in accordance with the FReM. We also confirmed that relevant parts of the remuneration report had been properly prepared and that information given in the management commentary was consistent with the financial statements.
12. We also reviewed the governance statement and concluded that it complied with Scottish Government guidance.

Regularity

13. We confirmed that the expenditure and income in the financial statements was in accordance with applicable legislation and Ministerial guidance.

Accounting issues

Accounts submission

14. We received the unaudited financial statements on 28 June 2013 in accordance with agreed timetables. Finance staff provided good support to the audit team enabling outstanding points

to be cleared. The revised financial statements were authorised for issue on 21 October 2013.

15. A number of presentational and monetary adjustments were identified within the financial statements during the course of our audit. These were discussed with senior finance officers who agreed to amend the unaudited financial statements. The net effect of these adjustments was to decrease total comprehensive net expenditure by £18,000.
16. Three monetary errors identified were not processed through the financial statements by management. If adjusted these would have a net effect of increasing net expenditure by £30,852 for the year, with a corresponding decrease in net assets on the statement of financial position.

Prior year adjustments

17. Prior year adjustments were made to include the financial results/ position of an associate company (Investors in People Scotland - IIPS), which had not been previously recognised and the correction of depreciation entries identified during the 2012/13 audit.
18. The effect on the 2011/12 financial statements of the inclusion of IIPS was to increase net assets by £0.262 million and to decrease net expenditure by £0.069 million. Highlands and Islands Enterprise have a 50% holding in IIPS along with Scottish Enterprise. In previous years IIPS was not included as an associate in Highlands and Islands Enterprise accounts on the basis of materiality.
19. Last year we reported that the asset register did not contain sufficient detail at individual asset level and this impacted on the accounting treatment of depreciation and revaluation transactions. The work carried out to address this also required an adjustment to the prior year figures, as explained at paragraph 25. The effect on the 2011/12 financial statements from correction of depreciation entries was to decrease expenditure by £0.149 million.

Events after the reporting date

20. Buckie Shipyard Limited (BSL) entered administration on 23 August 2013. In accordance with International Accounting Standards (IAS 10 Events after the reporting date), this constitutes an adjusting event which provides evidence of an impairment in the carrying value of Highlands and Islands Enterprise's loan to BSL at the year end. The carrying value is currently £0.553 million.
21. Officers advise that they have rights over elements of the asset as part of the loan security. The process to find a buyer for the site is in progress. No adjustment has been made to the outstanding value of the loan in the statement of financial position as Highlands and Islands Enterprise expect to recover the majority of the debt from the sale of the assets. A note has been included in the accounts to disclose this.

Capacity and skills mix

22. Highlands and Islands Enterprise provided the annual report and accounts for our audit commencing on 28 June, which was a week earlier than last year. During our audit fieldwork there were a number of issues that, when taken cumulatively, lead us to comment on the overall capacity and technical skill mix within the finance team which have had an impact on the audit process.
23. These capacity issues restricted the opportunity for a robust management review process when preparing the financial statements, resulting in errors. In addition, there was less time available to address technical matters. We might expect some of these issues, but the frequency is greater than other audited bodies. These issues resulted in more time being spent on audit queries and more presentational changes to the unaudited financial statements.
24. Each year an external accountancy firm is engaged to support the Head of Financial Services by preparing parts of the accounts but the points raised above highlight a capacity issue during the peak annual accounts period with little flexibility to absorb illness or any new emerging work priorities. We have discussed this with officers and there is recognition that this issue will be reviewed during 2013/14.

Refer Action Plan No. 1

Depreciation and revaluation of non-current assets

25. We raised significant issues last year around the accounting for non-current assets and there was a commitment from Highlands and Islands Enterprise to resolve this issue in time for the 2012/13 accounts. Some progress was made towards the agreed actions however completion of the detailed work was affected by resource issues in the finance team.
26. Officers carried out additional work on the non-current asset accounting entries and provided revised figures on 27 August. The adjustments were reviewed by us and the disclosure notes are now materially correct.
27. A number of areas of accounting treatment still require attention and will be revisited for the 2013/14 financial statements audit. This mainly relates to the assessment of the useful lives of assets. IAS16 Property, Plant and Equipment requires that on revaluation of an asset, the valuer should also reconsider the remaining useful life of the asset. The remaining years should then be used when calculating the subsequent annual depreciation charges. This is not currently being carried out.

Refer Action Plan No. 2

Financial position

28. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
29. We 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.
30. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

Annual outturn

31. The main financial objective for Highlands and Islands Enterprise is to ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers. Highlands and Islands Enterprise operated within the resource budgets for 2012/13. Table 1 below shows a number of significant grant-in-aid budget movements that occurred during the financial year with the net budget increasing by £15.2 million from the initial budget.

Table 1: Resource Budget

	Initial Budget (£'000)	Autumn Revision (£'000)	Spring Revision (£'000)	Final Budget (£'000)	Actual Outturn (£'000)	Under / (Over) spend
Resource DEL	30,300	3,000	(4,449)	28,851	28,851	-
Capital DEL	18,100	15,500	8,886	42,486	39,786	2,700
Total (Grant in aid)	48,400	18,500	4,437	71,337	68,637	2,700
Non Cash DEL	12,700	(3)	(7,697)	5,000	4,045	955
AME				19,500	17,023	2,477

Source: Grant in aid letters and RAB return schedule

32. Total expenditure is funded by grant-in-aid (GIA) and non-GIA income. A funding gap of £15.8 million was identified in the original budget and was primarily addressed through additional funding made available by the Scottish Government to be used for specific shovel-ready and energy capital projects. Clarification from the Scottish Government that most

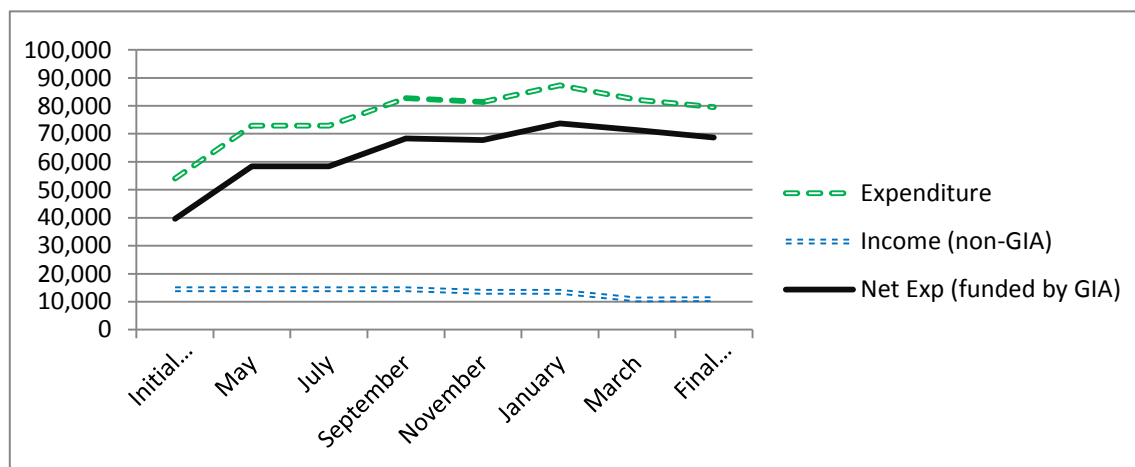
shovel-ready and additional capital allocations could be applied flexibly, allowed the identified funding gaps to be addressed. The bulk of this was due to Inverness Campus (£9.9 million) and Forres Enterprise Park (£3.5 million). The spring changes include a movement of revenue budget to capital, which reflects the nature of work in 2012/13.

- 33. As shown at table 1 a significant late adjustment of £19.5 million was awarded for AME (annually managed expenditure). 2011/12 was the first year AME was awarded, which means that expenditure previously charged against non-cash DEL is now charged against AME including the impairment of assets under construction.
- 34. Such large and late changes to the budget increase the risk that expenditure in quarter four does not meet project appraisal and payment procedures. Business Improvement and Internal Audit (BIIA) focus their annual testing of significant transactions on quarter four spend and as noted at paragraph 68 the results of the testing was satisfactory.

Budgetary control

- 35. Financial statements are presented to each Board meeting providing details of the financial results for the period and the forecast outturn for the financial year. The growth in expenditure reflects the increased GIA awarded during the year. See Exhibit 1 below.

Exhibit 1: Financial Reporting - forecast outturn



Source: Financial management reports to Board

- 36. All available resources for 2012/13 were applied with the exception of £2.7 million of shovel-ready funding originally allocated to Barmuckity Business Park. Delays in the progress of this project have prevented the funding from being drawn down in the year. In agreement with the Scottish Government this money was used to reduce year end creditors. There is some uncertainty whether Highlands and Islands Enterprise will need to refund this ongoing project from within their existing resources in 2013/14, possibly by reducing the grant in aid drawdown from the Scottish Government. This could have an adverse effect on either the payment of creditors (working capital) or on other potential project funding.

37. Non-GIA income was originally forecast at £14.5 million and up until January 2013 was forecast at £13.6 million. The final outturn at the year end was £10.872 million, 25% less than original budget. Non-GIA income included EU income of £2.6 million compared to budget of £5 million. EU income is matched to actual expenditure. Property sales amounted to £1.9 million against an original budget of £3.3 million reflecting current economic conditions and the impact of reduced bank lending on commercial property. Increased GIA reduced the pressure to meet external income target for 2012/13 but external income budgets remain at approximately £14 million for the next two years. Based on the difficulties experienced this year, it will be a challenge to achieve this level of income.

Financial position

38. Based on the information in this section of the report, we have concluded that, subject to any major change in pension valuations or Scottish Government funding, the financial position of Highlands and Islands Enterprise is stable and its activities are financially sustainable. Its income and expenditure on activities have been projected for a three-year period to 2016 based on continuing grant-in-aid provision from Scottish Government.
39. The net assets position of Highlands and Islands Enterprise at 31 March 2013 was £21 million (£27 million 2012/13). The main reason for the reduction in value was the increase in the pension liability from £14 million to £26 million, offset by an increase in non-current assets of £4 million.

Capital and investment 2012/13

40. During the year Highlands and Islands Enterprise had capital expenditure of £21.8 million (£11.9 million 2011/12). The majority of this expenditure was on the construction of assets with Inverness Campus accounting for £11.7 million. Significant expenditure was also made on the European Marine Science Park at Dunstaffnage (£3.8 million) and Forres Enterprise Park (£3.2 million).
41. Loans to businesses during the year amounted to £2.6 million.

Financial planning to support priority setting and cost reductions

42. In August 2011 *Scotland's public finances: Addressing the challenges* was published by the Auditor General and the Accounts Commission. The report provided an overview of the scale of budget cuts expected to be faced by the Scottish public sector in the period 2010/11 to 2014/15, and how public bodies were beginning to respond to the challenges of reducing expenditure. During 2012/13 we followed-up this report within Highlands and Islands Enterprise focusing on whether:
- there are sustainable financial plans which reflect a strategic approach to cost reduction; and
 - senior officials and non-executive directors demonstrate ownership of financial plans and the level of scrutiny applied.

43. The report was discussed at the September 2011 Risk and Assurance Committee, when senior management explained their commitment and plans to reducing their administration costs (Block B). The Block B expenditure in the accounts has decreased over the past three years and current and future budgets continue to show planned reductions in spend.

Table 2: Management, staff and administration costs

	Budget		Actual		
	£m		£m		
	2014/15	2013/14	2012/13	2011/12	2010/11
Management, staff and administration costs	14.9	14.9	15.1	15.4	16.1

Source: HIE accounts and budget reports

44. Savings from earlier voluntary severance programmes contributed to the majority of these savings. Future savings are planned to come from premises and administration costs. The review of office accommodation and the Office for the 21st Century are examples of projects established to generate future efficiencies.
45. When setting the budget, senior finance officers consider the commitment position from the previous year and make any required adjustment relevant to the current year. Budgets for each business unit are then set based on a discretionary amount which is allocated after agreement by the Leadership Team.
46. On a weekly basis the finance team provides updates on performance against budget to the Leadership Team with monthly management accounts prepared, which are subject to scrutiny at each Board meeting.

Outlook

2013/14 budget

47. In April 2013 the Board approved a budget for 2013/14 of £83.8 million including the non-cash allocation of £12.7 million. The expenditure is funded from different sources as shown in Table 3 below. As highlighted by the Director of Finance and Corporate Services, there are various risks attached to the budget.
48. The budget includes Highlands and Islands Enterprise's share of the Scottish Government's Strategic Forum Savings Target of £2.0 million (2012/13 £1.6m), which cannot be fully delivered through admin savings and will impact level of investment available.
49. As detailed in paragraph 36, there is uncertainty over £2.7 million underspend in 2012/13 involving a specific shovel-ready project and the impact on the 2013/14 budget. This remains to be clarified with Scottish Government's Finance Team.

Refer Action Plan No. 3

50. The budget excludes funding for ring-fenced projects such as broadband and Scottish Land Fund which Highlands and Islands Enterprise lead on behalf of the Scottish Government.
51. The 2013/14 budget process identifies the need for additional income, not in the budget, of £9.3 million based on pipeline activity. The spending gap included HIE office accommodation of £3.5 million and chemical plant in the Western Isles of £3 million. During 2013/14, as part of the ongoing management of pipeline projects, the Western isles project was completed and the HIE office project was re-phased into 2014/15.

2013/14 budget reporting

52. Recent financial reporting to the Board shows expenditure to the end of July 2013 of £36.8 million against a profile position of £43.8 million (84% of profile). The report shows a forecast outturn within budget for the year.

Financial forecasts beyond 2013/14

53. The Operating Plan 2012-15 contains a three-year financial plan outlining the forecast expenditure across each key business area and the associated projected income. The final year covered by the plan is 2014/15. As part of recent public sector spending review, an additional £10.2 million was awarded to Highlands and Islands Enterprise for 2014/15. Budgets for 2015/16 onwards will be part of the next operating plan, which will be submitted to the Board for approval in December 2013. See the detailed financial plans in Table 3.

Pension fund

54. The pension liability in the statement of financial position has risen from £9.3 million to £25.6 million over the last three years. This is mainly attributable to the increase in the liabilities of the Highlands and Islands Enterprise Superannuation Scheme (the scheme) by £11.9 million over the period.
55. The scheme currently has a recovery plan in place, which was agreed with the Trustees and the Pension Fund Regulator (PFR) in 2010 to address the funding position. At the last formal valuation at March 2012 the results indicated a deficit of £27 million.
56. The recovery plan requires Highlands and Islands Enterprise to pay employer contributions at 24.9% and an annual sum of £0.5 million for a period of 15 years. The plan also included a review of the level of employee contributions and benefits to enable the scheme to meet the requirements of the Hutton review of public sector pensions. A revised recovery plan is currently being negotiated and, with successful consultation with staff, will include an increase in employee contributions to 6% over a 3 year period.
57. A detailed timetable and action plan is currently being prepared with trustees, actuaries and unions which will allow for implementation in time for the April 2014 pay remit to the Scottish Government.

Table 3: Financial Plan

	2013/14 £m	2014/15 £m
Investment	56.2	58.8
Management, staff and admin (Block B)	14.9	14.9
DEL/AME non cash expenditure	12.7	12.7
Total	83.8	86.4
Funded by:		
Grant in Aid	48.4	48.4
Grant in Aid additional	5.9	10.2
DEL/AME non cash funding	12.7	12.7
Shovel ready (see paragraph 49)	2.7	-
European funds	5.0	5.0
Capital receipts	3.3	4.5
Revenue receipts	5.8	5.6
Total funding	83.8	86.4

Source: Board papers - financial budgets 2013/14; additional funding from spending review

Governance and accountability

58. 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.
59. 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.
60. Consistent with the wider scope of public audit, we 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
61. In this part of the report we comment on key areas of governance.

Corporate governance

Overall effectiveness

62. We found that overall, corporate governance arrangements operated effectively during 2012/13.

Processes and committees

63. The Board has overall responsibility for ensuring that Highlands and Islands Enterprise fulfils its statutory duties and the aims and objectives set out by the Scottish Government in its Economic Strategy. The Board is supported by two committees, the Remuneration Committee and the Risk and Assurance Committee (RAC).
64. In March 2013 the RAC held a member training session and undertook a high level review of its effectiveness. As a result a number of improvement actions were identified for follow up during 2013/14 including an assessment against best practice guidance in the Scottish Government Audit Committee handbook.

Internal control

65. 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 of audited bodies as a whole. The extent of this work is informed by our assessment of risk and the activities of internal audit.

66. Overall the systems of internal control were operating effectively during 2012/13. This enabled us to take the planned assurance on these systems for the audit of the financial statements. We also identified a number of control weakness or where improvements could be made to existing arrangements.
67. 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 internal audit work of BIIA is of a good quality allowing us to place reliance on a number of areas including significant transactions and procurement cards. This not only avoided duplication of effort but also enabled us to focus on other key risk areas.

Business Improvement and Internal Audit

68. As reported in our annual audit plan the BIIA has other responsibilities in addition to internal audit. This team also has responsibility for customer service activity and from 2013 dealing with Freedom of Information requests. The expanding role of BIIA presents potential risks to the perceived independence of the team. However, this risk is fully appreciated by the Head of BIIA and there is general acceptance that, when necessary, BIIA will arrange for external independent reviews of any potential areas of conflict. Internal audit continues to deliver their audit plan and we have not seen any evidence of a lack of challenge in the work undertaken.

Governance statement

69. In 2012/13 Highlands and Islands Enterprise included a governance statement in its annual accounts, as required. In accordance with Scottish Government guidance, this included description and assessment of the essential components of corporate governance and details of any significant risk-related matters arising during the period.

Prevention and detection of fraud and irregularities

70. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Highlands and Islands Enterprise has robust arrangements in place to prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and board members.

NFI in Scotland

71. HIE participates in the National Fraud Initiative (NFI). This is a counter-fraud exercise that uses computerised techniques to compare information about individuals held by different public bodies to identify circumstances that might suggest the existence of fraud or error (matches). Where matches are identified public bodies are expected to investigate these and if fraud and error has taken place, to stop payments and attempt to recover the amounts involved. The exercise also provides assurance on the effectiveness of arrangements and helps deter fraud.

72. In the 2013 exercise, Highlands and Islands Enterprise had 229 matches identified with 31 recommended matches requiring follow up. In line with their locally agreed approach, officers investigated 81 matches. The work carried out did not identify any significant issues although one payroll match highlighted a national insurance number match with another organisation. On investigation it was noted that there had been a transposition error when entering the number on the payroll system. Officers have liaised with HMRC to confirm the error and to reallocate contributions as necessary.

Fraud investigation

73. In 2011/12 BIIA carried out an investigation into a building grant made to an independent hostel. The investigation was prompted by a complaint from a supplier who had not been paid for work done. Following the BIIA review it was found that some payments had been made in cash, but did not have sufficient evidence to support the payments being made. The information was passed to the police for investigation and in July 2013 the applicants were found guilty of fraud against Highlands and Islands Enterprise and sentenced. Civil recovery is now being pursued for approximately £11, 000.

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

74. 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. We consider whether bodies have adequate arrangements in place.
75. No issues have been identified by us for inclusion in this report.

Outlook

76. Five out of the eight current board members have appointment expiry dates of 31 March 2014. The process to recruit new members will be undertaken by Scottish Government early next year.
77. Cairngorm Mountain Limited has been a wholly owned subsidiary of Highlands and Islands Enterprise since 2008. A procurement exercise commenced in 2012 to find a new operator for the facilities at Cairngorm Mountain. The process is at an advanced stage with two bidders accepted through to the next stage of dialogue. Depending on the outcome of this stage it is anticipated that a decision will be made by the end of the year to either appoint a new operator, or to retain the status quo.

- 78.

Best Value, use of resources and performance

79. Audited bodies have responsibility to ensure that arrangements have been made to secure best value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of best value. Where such requirements are not specified we may, in conjunction with audited bodies, agree to undertake local work in this area.
80. As part of their statutory responsibilities, the Auditor General may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. We 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.
81. During the course of our audit appointment we also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years. We may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments.
82. This section includes a commentary on the best value and performance management arrangements within Highlands and Islands Enterprise. We also summarise headline performance measures used by Highlands and Islands Enterprise, highlight any relevant national reports and comment on the body's response to these.

Management arrangements

Best Value

83. 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 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.
84. Highlands and Islands Enterprise's Operating Plan 2012-15 includes the following areas of specific focus to support its commitment to delivering best value:
- Effective collaboration
 - Governance environment
 - Business improvement

- Equality and delivery
 - Carbon footprint.
85. In 2012/13 the BIIA carried out various activities linked to best value which were reported to the June 2013 Risk and Assurance Committee. This included piloting the implementation of a business excellence model; helping with 'lessons-learned' case conferences and developing a business monitoring template to identify common issues. A matrix has been developed which demonstrates the alignment of Highlands and Islands Enterprise's vision and corporate priorities across a range of external best practice models including best value, corporate expectations, business excellence and the 'Change the World' model.
86. For 2013/14 this will form the basis of a strategic business improvement programme which will provide a framework for the continuous improvement activity of the organisation and the way in which it addresses its strategic priorities.

Overview of reported performance in 2012/13

87. The Scottish Government Economic Strategy sets out high-level targets for increasing Scotland's sustainable economic growth. These targets, along with the 16 national outcomes, inform the development of desired outcomes for the region and, in turn, the choice of regionally significant investments and enterprise programmes that Highlands and Islands Enterprise delivers. The Operating Plan 2012-15 details the performance framework and highlights the areas where interventions contribute to the national outcomes and purpose targets as set out in the National Performance Framework. Performance information is provided against the following key measures:
- forecast increase in turnover by supporting businesses
 - forecast increase in sales outwith Scotland by supported businesses
 - jobs supported
 - jobs supported in fragile areas
 - forecast increase in turnover in the social economy
 - forecast increase in turnover generated by community owned assets
 - cumulative number of account managed communities support to implement growth plans.
88. During 2012/13 all the above measures were achieved with performance exceeding target in a number of areas with investments totalling £20 million resulting in the creation or retention of 809 jobs across the region, with 158 in fragile areas.

National performance reports

89. 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 1 below.

Exhibit 2: A selection of national performance reports 2012/13

- | | |
|---|---|
| <ul style="list-style-type: none">• Developing financial reporting in Scotland• Renewable energy | <ul style="list-style-type: none">• Managing ICT Projects• The National Fraud Initiative in Scotland |
|---|---|

Source: www.audit-scotland.gov.uk

90. Each of the national performance reports above were taken to the Risk and Assurance Committee for their consideration. The following reports were subject to additional scrutiny.

Managing ICT projects

91. In August 2012 Audit Scotland published a report on Managing ICT Contracts which focused on 3 specific projects. The audit concentrated on the planning and governance arrangements, including progress reporting and risk management of each of the contracts.
92. The report provided a list of key challenge and scrutiny questions for senior management and Board members to consider in the planning process.
93. Highlands and Islands Enterprise used these prompts as the basis of an initial review of Project Apollo, the project created to develop a new special purpose vehicle to manage delivery of information systems to similar public sector bodies. The programme Board has representatives from Highlands and Islands Enterprise, Scottish Enterprise and Skills Development Scotland. As the project is at an early stage the questions were only considered to the extent that they are relevant.
94. A report was presented to the Risk and Assurance Committee with a number of actions to be followed up.

Renewable energy

95. In September 2013 Audit Scotland published a report on Renewable energy. This report looked at public sector action and investment in developing renewable energy and what has been delivered to date.
96. Investment in the renewable energy sector is a key priority for Highlands and Islands Enterprise with particular emphasis on marine and wind energy projects. Audit Scotland presented the key messages to the September Risk and Assurance Committee meeting when non-executives and senior management discussed in detail the findings.

Outlook

97. The principal method of delivery of advice and support to businesses and social enterprises is by account management. An internal review of Highlands and Islands Enterprise's account managed portfolio will take place during 2013/14 and the findings will provide the basis of an external evaluation which has been commissioned to assess the effectiveness of the support provided to businesses.

Appendix A: audit reports

External audit reports and audit opinions issued for 2012/13

Title of report or opinion	Date of issue	Date presented to Audit and Risk Committee
Annual Audit Plan	26 February 2013	5 March 2013
Key financial controls assurance report	29 May 2013	4 June 2013
Report on financial statements to those charged with governance	12 September 2013	17 September 2013
Audit opinion on the 2012/13 financial statements	12 September 2013	17 September 2013

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	24	<p>Capacity and skills mix</p> <p>During the 2012/13 financial statements audit concerns were raised relating to capacity and skills mix in the finance team.</p> <p>Risk</p> <p><i>Insufficient resources during the preparation and audit of the financial statements may lead to a higher than expected level of errors and increased time spent on corrective work.</i></p>	The Finance Team has agreed to investigate options to increase resourcing and capacity for future audits. This may include increasing current part time staff to full time commitment for the duration of the annual accounts and possibly augment this with additional resource from within the wider finance team.	Director of Financial and Corporate Services	31 March 2014
2	27	<p>Non-current assets</p> <p>For 2013/14 further work is required to demonstrate an annual review of the remaining lives of assets.</p> <p>Risk</p> <p><i>Depreciation is not being calculated and accounted for in accordance with IAS16.</i></p>	Early engagement with audit to reach an understanding of what work remains to be done to ensure that all the requirements of IAS16 are met in time for preparation of 2013/14 accounts.	Head of Financial Services	31 March 2014
3	49	<p>Shovel ready funding</p> <p>Income assumptions for 2013/14 include a release from reserves of £2.7 million relating to an underspend in 2012/13 involving a specific shovel ready project. There is uncertainty in relation to how this should be treated and whether the 2013/14</p>	HIE are actively negotiating with Scottish Government on this matter. A business case has been prepared and submitted for ministerial review and resolution in early November.	Director of Financial and Corporate Services	November 2013

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		grant in aid will be reduced. Risk <i>There is a risk that the 2013/14 income is adversely affected.</i>			