Appendix C

Scottish Enterprise

Annual report on the 2012/13 audit

AUDIT SCOTLAND

Prepared for Scottish Enterprise and the Auditor General for Scotland
June 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 opinion that the financial statements of Scottish Enterprise for 2012/13 give a true and fair view of the state of the body's affairs and of its net expenditure for the year.

The 2012/13 Annual Accounts include severance costs of £540,000. We considered specific issues of compliance with the Scottish Government's approval for these voluntary severances and concluded that the conditions had been met and that governance and process improvements (identified in last year's report) had been made.

During 2012/13 Scottish Enterprise wrote off debts and investment losses of £9.5 million. Scottish Enterprise contacted the Scottish Government for approval for three of these write offs. This was received on 19 June 2013. We have reviewed the basis for the write offs and are satisfied that these are appropriate and the recoverable values are correctly reflected in the financial statements.

Overall the system of internal control and arrangements for the prevention and detection of fraud were satisfactory during 2012/13. However during the year a member of staff amended the bank account records of a number of suppliers within BACS payment files prior to transmission to the bank. This resulted in a £26,300 loss. The member of staff has been dismissed and the Police have been informed. Their investigation is on-going. The National Fraud Initiative (NFI) process also identified one instance where, during 2009, two suppliers had invoiced and been paid £101,000 for the same service. Scottish Enterprise has taken action to recover the payment made to the previous supplier of the service.

Outlook

We confirm the financial sustainability of Scottish Enterprise on the basis of its financial position and projected three-year financial summary. In overall terms Scottish Enterprise plans detail increased levels of investment in economic development over the next three years and the 13/14 budget takes into account the £11 million contribution to the £25 million savings target of the Strategic Forum partners. As noted last year, Scottish Enterprise has continued to face difficulties in securing income from property disposals given current market conditions and, during 2012/13, has revised its estimates downwards. In particular the outcome of a judicial review may have a further bearing on the achievement of property sales proceeds during 2013/14.

Introduction

1. This report is the summary of our findings arising from the 2012/13 audit of Scottish Enterprise. The purpose of the report is to set out concisely the scope, nature and extent of the audit. It summarises our opinions (i.e. on the financial statements) and conclusions on significant issues arising.

2. The report also reflects our overall responsibility to carry out an audit in accordance with the public sector audit model which is based on the Code of Audit Practice prepared by Audit Scotland (May 2011). This sets out the wider dimensions of the public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements prepared by management; however this does not relieve management of their responsibilities in this respect. This report has been prepared for the use of Scottish Enterprise and no responsibility to any third party is accepted.

3. Appendix A 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. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.

4. This report is also addressed to the Auditor General for Scotland and will be published on our website after consideration by the Audit Committee.

Matters to be reported

Conduct and scope of the audit

5. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in the Annual Audit Plan presented to the Audit Committee on 12 December 2012, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.

6. As part of the requirement to provide full and fair disclosure of matters relating to our independence we can confirm that we have not undertaken non-audit related services. The 2012/13 agreed fee for the audit was disclosed in the Annual Audit Plan and as we did not require to carry out any additional work outwith our planned audit activity this fee remains unchanged.

Audit opinion & accounting issues

7. We have given an unqualified opinion that the financial statements of Scottish Enterprise for 2012/13 give a true and fair view of the state of the body's affairs and of its net expenditure for the year. The audit opinion was formally issued and signed on 28 June 2013.

8. We received the unaudited single entity financial statements on 13 May 2013, and the full unaudited financial statements, including management commentary, remuneration report, governance statements and group financial statements on 28 May 2013, in accordance with the agreed timetable. The working papers were of a good standard and the staff provided support to the audit team allowing us to complete our on-site fieldwork on 7 June 2013. Scottish Enterprise is required to follow the 2012/13 Government Financial Reporting Manual and we can confirm that the financial statements have been properly prepared in accordance with these accounting requirements.

Significant findings (ISA260)

9. The following matters emerged during the course of the audit.

10. **VAT income.** Information in relation to a backdated claim, received after the balance sheet date, amended the value of an existing VAT debtor. This correction was incorporated into the financial statements during the audit process. The VAT debtor increased from £0.5 million to £1.8 million as a result of the new information.

11. **Scottish Government approval for write offs.** A significant element of Scottish Enterprise's business is the provision of grants, loans and equity investment to a range of businesses. As a result of the inherent risks in this funding activity, Scottish Enterprise has occasion to write off amounts which are not recoverable due to the financial or legal position of the funding recipients. At present, the Management Statement between Scottish Enterprise and Scottish Government requires that Scottish Government approval must be given for the write off of

debts over £250,000. This requirement exists even when companies have gone in to liquidation or been dissolved and there is no prospect of any repayment,

12. During 2012/13 Scottish Enterprise wrote off debts and investment losses amounting to £9.5 million of which 3 items were in excess of the delegated authority limit. Scottish Enterprise has contacted the Scottish Government for approval and this was received on 19 June 2013. We have reviewed the basis for the write downs and are satisfied that these are appropriate and the recoverable values are correctly reflected in the financial statements.

Whole of Government Accounts

13. The whole of government accounts (WGA) are the consolidated financial statements for all branches of government in the UK. Scottish Enterprise is required to submit the consolidation pack to support its 2012/13 WGA return to the Scottish Government prior to the deadline of 31 July 2013. The audit deadline is 23 August 2013. As a result of the introduction of a new system there have been some delays in the issue of the consolidation packs by Scottish Government. There is a possibility that the above deadlines may not be achieved.

Financial position

2012/13 Outturn

14. 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.

15. Scottish Enterprise operated within the resource budgets for 2012/13 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)	Final Budget (£'000)	Actual Outturn (£'000)	Under / (Over) utilised
Resource DEL	188,300	163,891	161,880	2, 011
Capital DEL	42,600	71,500	71,479	21
Total	**230,900**	**235,391**	**233,359**	**2,032**
Non Cash DEL	27,772	7,000	4,615	**2,385**
AME	-	5,850	3,293	**2,557**

Source: Grant-in-aid Funding Letters

16. Compared to the previous year, this year's overall expenditure of Scottish Enterprise Group reduced from £298 million to £269 million (10%), mainly reflecting a significant decrease in the impairment charges of property and investments and lower income generated from property

disposals. The segmental analysis of expenditure, within the financial statements, identifies changes in the emphasis of activity of the organisation. Some of these are a result of the cyclical nature of some major medium/ long-term activities. For example, Scottish Enterprise has substantially concluded its investment in business infrastructure at the Edinburgh Bioquarter. Other changes are as a result of policy initiatives: the transfer of funding responsibility for the Urban Regeneration Companies (URCs) and the increasing expenditure on investment in renewables.

17. During 2012/13, the Scottish Investment Bank completed a large volume of deals which resulted in overall expenditure increasing by over a third on the previous financial year. This illustrated the continued market reliance on SIB co-investment and the on-going challenges faced by companies trying to secure scarce private sector funding. However, the demand for SIB investment products was variable with significant demand experienced on both the Scottish Venture Fund and in relation to direct investment opportunities. In contrast the demands placed on the Scottish Co-Investment Fund (SCF) and the Scottish Loan Fund (SLF) were lower than originally anticipated in Scottish Enterprise's Business Plan. There is a commitment to invest £50m over 5 years in the Scottish Loan Fund with current investment sitting at £9.5 million; the remaining £40m is held as part of cash and cash equivalents. The investment is based on draw-down by Maven Capital Partners and is lower than originally planned due to the recycling of monies received from investments. In total, the remaining funds to be invested through SLF and SCF has decreased but at a slower rate than originally planned and this has resulted in 60% of the cash balances held by SE being attributable to these investment funds.

2012/13 Financial position

18. At 31 March 2013 Scottish Enterprise's statement of financial position shows a decrease in total equity of £10.4 million. This can be attributed, among other things, to the reduction in value of Scottish Enterprise's pension fund asset from £58.5 million to £25.8 million, offset by a £20 million increase in the value of financial investments held. Both of the values are based on annual independent valuations at the year end.

19. The financial position of Scottish Enterprise remains stable. Its income and expenditure on activities have been projected for a 3 year period to 2016 based on continuing grant-in-aid provision from Scottish Government. The budget takes into account the reduction of £10.8 million to the budget, which is required as a contribution to the £25 million savings target of the Strategic Forum partners for 2013/14.

Financial planning

20. *Scotland's public finances: Addressing the challenges* was published by the Auditor General and the Accounts Commission in August 2011. 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 Scottish 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.

21. Scottish Enterprise has a 3 year business plan providing financial information for the current financial year and indicative budgets for the following 2 years based on relatively stable grant-in-aid provision. Having previously used a zero-based budgeting process Scottish Enterprise are now using a rolling programme based on the longer term priorities outlined in the Government Economic Strategy.

22. The budget setting process involves significant input from senior officials and Board members and there is clear ownership of the business plan, which contains the financial summary. Financial and performance monitoring reports are subject to scrutiny at each Board meeting. A formal re-evaluation of the budget is undertaken at the mid-point of the financial year to ensure that resources are appropriately targeted to address economic development opportunities.

23. In February 2013 the Board approved a balanced budget for 2013/14 of £336 million (£306 million in 2012/13). The main areas where the budget has increased is expenditure on Innovation and R&D support (£10 million), RSA and SMART support (£8 million) and Business Infrastructure projects (£8 million). For 2013/14 a budget allocation of £31.5 million has been given for the provision of equity investment and loans via the Renewable Energy Investment Fund (REIF). These allocations reflect the key strategic priorities which Scottish Enterprise has identified in its 2013-16 Business Plan.

24. The most recent Finance and Performance report covering the period to 30 April highlighted that Scottish Enterprise could potentially deliver an additional £11.3 million of economic development investment during 2013/14. This represents 3% of the Business Plan budget of £336 million. . We reported in 2011/12 that there remains uncertainty around the projected property income and Scottish Enterprise revised its mid-year estimates in this area last year. Looking to 2013/14, the principal uncertainty surrounds the planned income of £11 million from the disposal of property at the West Mains site in East Kilbride which is currently subject to judicial review. The outcome of the judicial review remains uncertain and Scottish Enterprise has identified that it has plans in place to deal with the consequences of the decision.

Refer Action Plan no.1

Corporate governance and systems of internal control

Overall governance arrangements

25. The Code of Audit Practice gives auditors a responsibility to review and report on audited bodies' corporate governance arrangements and overall we found that Scottish Enterprise had

sound governance arrangements in place which included a number of committees overseeing key aspects of governance.

26. The financial statements include expenditure of £540,000 in relation to voluntary severances for staff in the "wider re-deployment pool". We looked at severance arrangements last year and identified that governance and process improvements could be made. Our work this year highlighted that the expected improvements have been implemented.

27. Scottish Enterprise sought and received approval from Scottish Government for these severances. The Scottish Government, in its approval letters noted, that Scottish Enterprise's severance terms are contractually more generous than the severance terms provided for in the Civil Service Compensation Scheme, but acknowledged that Scottish Enterprise has agreed to amend its terms. A draft revised policy was submitted to the Scottish Government in May 2013.

28. The Scottish Government approval letters set out clear conditions and these have been met. These included requirements for business cases demonstrating the payback period and explicit approval by the Executive Leadership Team.

29. These cases will be reported to the Remuneration Committee for information.

Accounting and internal control systems

30. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.

31. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

32. Internal audit is an important element of Scottish Enterprise's governance structure. 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 key project and Scottish Investment Bank investment controls. This not only avoided duplication of effort but also enabled us to focus on other key risk areas.

33. ATOS origin provides IT services to Scottish Enterprise, Skills Development Scotland and Highlands and Islands Enterprise. Skills Development Scotland is leading the development of a service audit report (ISAE 3402) for this service. It was expected that this would be in place for the 2012/13 audit but the report is not yet available and this has been noted in the Governance Statement. We understand that work is underway but may not be reported on until late June or early July.

Prevention and detection of fraud and irregularity

34. In our Annual Audit Plan we highlighted the responsibility audited bodies have for establishing arrangements to prevent and detect fraud and other irregularities. In our opinion the overall arrangements for the prevention of fraud within Scottish Enterprise are satisfactory, although it should be noted that no system can eliminate the risk of fraud entirely.

35. During the year a member of staff caused a loss of £26,300 to Scottish Enterprise from 11 fraudulent payments. The bank account records of a number of suppliers within the BACS payment files were amended prior to transmission to the bank. The individual had used a number of different methods to conceal these misappropriations. The staff member has been dismissed, the Police have been fully informed and their investigation is on-going.

NFI in Scotland

36. Audit Scotland coordinates a major counter-fraud exercise working together with a range of Scottish public bodies, external auditors and the Audit Commission. These exercises, known as the National Fraud Initiative in Scotland (NFI), are undertaken every two years as part of the statutory audits of the participating bodies. The latest exercise started during 2012 but is not due to report until May 2014.

37. The NFI works by using data matching to compare a range of information held on bodies' systems to identify potential inconsistencies or circumstances that could indicate fraud or error which are called 'matches'. Where matches are identified these are made available to bodies to investigate. Scottish Enterprise had 2,672 matching reports with the majority of these creditor matches (2,656) and a small number of payroll matches (16). Scottish Enterprise investigated all of the payroll matches and all creditor matches recommended for further review by NFI.

38. As a result of the process, officers identified a situation where a change in the landlord and managing agent for a Scottish Enterprise office was made during 2009 and invoices for the following quarter were submitted by both companies and paid by Scottish Enterprise. The overpaid amount has been reclaimed and payment is awaited.

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

39. 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. No issues have been identified by us for inclusion in this report.

Best value

Best value

40. Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily. 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 Scottish Enterprise agree to undertake local work in this area

41. Scottish Enterprise has recently carried out a detailed review of its business planning and resource allocation process and has considered the Audit Scotland best value toolkit on planning and resource alignment.

Acknowledgements

42. We would like to express our thanks to the staff of Scottish Enterprise for their help and assistance during the audit of this year's financial statements which has enabled us to provide an audit report within the agreed timetable.

Appendix A: Action Plan

Issues and Planned Management Action

Action Point	Refer Para No	Issue Identified	Planned Management Action	Responsible Officer	Target Date
1	24	The 2013/14 budget includes £11million from the planned disposal of a site at West Mains, East Kilbride. This is subject to a judicial review and the outcome of this review is not yet known. If the outcome is counter to Scottish Enterprise's interests it is unlikely that alternative disposals could be secured for this amount. There is a risk that Scottish Enterprise will need to revise its budget in 2013/14 to reflect 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.	Iain Scott, Chief Financial Officer	31 October 2013