Appendix C

Scottish Enterprise

Annual report on the 2013/14 audit

AUDIT SCOTLAND

Prepared for Scottish Enterprise and the Auditor General for Scotland
June 2014

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

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Key Messages

2013/14

We have given an unqualified opinion that the financial statements of Scottish Enterprise for 2013/14 give a true and fair view of the state of the body's affairs and of its net expenditure for the year.

The 2013/14 Annual Accounts included severance costs of £257,000 and we ensured that these payments met with Scottish Government's approval process for voluntary severances. Scottish Enterprise has submitted a revised voluntary severance scheme to the Scottish Government Remuneration Committee for comment and is awaiting feedback from this committee.

Debts and Investment losses of £13.1million were written off during the year and Scottish Enterprise contacted the Scottish Government for approval for 2 of these write offs totalling £1.3 million. This was received on 23 June 2014. 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.

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's business plan for 2014-17 details a slightly decreased level of investment in economic development over the next three years and the 13/14 budget takes into account the £17.5 million contribution to the Strategic Forum partners saving.

Introduction

1. This report is the summary of our findings arising from the 2013/14 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 sets out the key audit risks identified at the planning stage and details how we addressed each risk in arriving at our opinion on the financial statements.
4. We have not identified any high level risks from the audit.
5. This report is also addressed to the Auditor General for Scotland and will be published on our website after consideration by the Audit Committee.

Financial statements

Conduct and scope of the audit

6. 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 3 December 2013, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.

7. 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 2013/14 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

8. We have given an unqualified opinion that the financial statements of Scottish Enterprise for 2013/14 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 27 June 2014.

9. We received the unaudited financial statements on 13 May 2014 which was just a day later than the agreed timetable. The working papers were of a high standard and the staff provided good support to the audit team and we completed our on-site fieldwork on 6 June 2014. We received the first version of the unaudited group accounts on 27 May 2014.

10. The main changes to the accounts during the audit are detailed below:
    - Net expenditure increased by £2.1 million representing an accrual of shared staff costs incurred by SDS on the Enterprise Information Systems (EIS). The unaudited accounts did not include the final position from SDS.
    - The first version of the group accounts received on 27 May 2014 did not include the results for SE Fife. The assets of SE Fife are comprised in their entirety of SE Fife’s interest in two investment funds, Sigma Innovation Fund (East of Scotland) and Sigma Sustainable Energies Fund. The funds are in the process of being merged and as a result their accounts were not available until later in the audit process than with previous years. The final figures were received on 10 June 2014 and the amendments agreed to the revised accounts received on 11 June 2014.
    - From discussion with officers a new provision has been included in the financial statements. SE has a formal agreement with Dumfries and Galloway Council to make a contribution to the cost of upgrading a road adjacent to two areas of development land, part of which is owned by SE. The works are in progress and represent a legal obligation which becomes payable only after the works are complete and when SE sell or transfer its ownership of the adjacent land or on the 7th anniversary of the agreement. The

criteria for accounting for this as a provision has been met and the maximum contribution of £450,000 payable has been recognised in the financial statements.

11. In accordance with its Accounts Direction, Scottish Enterprise is required to comply with the 2013/14 FReM and additional disclosure requirements set out in Schedule 1 to the Accounts Direction. We can confirm that the financial statements have been properly prepared in accordance with these accounting requirements.

Significant findings and key judgements (ISA260)

12. During the course of the audit we identified one significant issue that we are requires to communicate in accordance with ISA 260.

13. **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 into liquidation or been dissolved and there is no prospect of any repayment.

14. During 2013/14 Scottish Enterprise wrote off debts and investment losses amounting to £13.1 million of which 2 items were in excess of the delegated authority limit (£1.3 million). Scottish Enterprise contacted the Scottish Government for approval and this was received on 23 June 2014. 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

15. 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 consolidated pack to support its 2013/14 WGA return to the Scottish Government prior to the deadline of 30 June 2014. The WGA audit remains ongoing and we anticipate that the audited return will be submitted by the target date of 15 August 2014.

Financial position

2012/13 Outturn

16. 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.

17. Scottish Enterprise operated within the resource budgets for 2013/14 as detailed in Table 1 below.

Table 1: Resource Budget

	Initial Budget (£'000)	Final Budget (£'000)	Actual Outturn (£'000)	Under / (Over) spend
Resource DEL	210,720	164,655	151,615	13,040
Capital DEL	20,400	84,275	96,313	(12,038)
Total	231,120	248,930	247,928	1,002
Non Cash DEL	27,772	22,051	5,178	16,873
AME	-	35,950	28,205	7,745

Source: Grant in Aid Funding letters

18. It was agreed with the Scottish Government that £40 million of revenue funding would be transferred to capital along with an additional budget of £16 million for the Renewables Energy Investment Fund and £10 million for the POWERS initiative. Expenditure in these areas is included within this year's overall expenditure for the Scottish Enterprise Group which has increased from £272 million to £296 million. This reflects the increased spend on RSA and innovation. The segmental analysis of expenditure within the financial statements identifies the changes in emphasis of the activities of the organisation. Spend on "Innovation" substantially increased in part due to the £6 million payment to Samsung under the POWERS R&D grant although we noted that actual expenditure was below forecast due to the slippage on the WATERS programme.

19. During 2013/14, the Scottish Investment Bank completed a large volume of deals. There was significant demand for Scottish Co-Investment Fund (SCF) and direct investment opportunities but the take up of the Scottish Loan Fund (SLF) was lower than originally anticipated which has resulted in a balance of £59 million being held within cash and cash equivalents for SCF and SLF. Another area that proved challenging was Offshore Renewables with investment and activity significantly below planned levels due to market and regulatory uncertainties. This has impacted on the progress of the Renewable Energy Investment Fund (REIF) and Scottish Enterprise has re-examined the rationale underlying its approach in this area.

2013/14 financial position

20. At 31 March 2014 Scottish Enterprise's statement of financial position shows an increase in total equity of £52 million which can be attributed to the increase in the value of Scottish Enterprise's pension fund assets (£53 million). This value was subject to an independent valuation at the year end.

21. The financial position of Scottish Enterprise remains stable with an excess of total and current assets over liabilities and positive cashflows (taking into account Scottish Government grants). A balanced budget of income and expenditure is projected for a 3 year period to 2017 based on continuing Grant in Aid provision from Scottish Government. The budget takes account of

the £17.3 million reduction to budget which is required as a contribution to the Strategic Forum partners saving for 2014/15.

Financial planning

22. The 2014/17 Business Plan was approved at the February board meeting and it details a balanced budget of £330 million for 2014/15 and indicative budgets for the following 2 years based on a relatively stable grant in aid provision.

23. The most recent Finance and Performance report covered the period to April 2014 and it details additional forecast investment taking Scottish Enterprise's expenditure to £333 million during 2014/15. The increased forecast for the financial year is mainly due to new project opportunities being identified and increased expenditure requirements on existing projects. The most significant changes at strategic priority level are increased budgets for REIF, WATERS and POWERS initiatives. The latest expenditure forecast of £333 million exceeds Scottish Enterprise's current income projection by £1.2million (0.3%) after taking account of additional forecast income of £1.4 million.

Corporate governance and systems of internal control

Overall governance arrangements

24. 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 standing committees overseeing key aspects of governance.

25. The financial statements include expenditure of £257,000 in relation to voluntary severances for staff in the "wider re-deployment pool". Scottish Enterprise sought, and received, approval from Scottish Government for these severances. Scottish Government previously advised that Scottish Enterprise had to revise its severance scheme to bring it more in to line with the Civil Service Compensation Scheme. A revised draft scheme was submitted to the Scottish Government Remuneration Committee in January 2014. Scottish Enterprise is awaiting feedback from this committee before proceeding with the new scheme.

26. An area of good practice undertaken by Scottish Enterprise relates to staff and board members completing Register of Interests forms which highlight where there may be a potential conflict of interest. This process extends to all Scottish Enterprise staff and is renewed annually. Details for non executive board members are contained within the financial statements.

Accounting and internal control systems

27. 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.

28. 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.

29. 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. This avoided duplication of effort but also enabled us to focus on other key risk areas.

30. ATOS origin provides IT services to Scottish Enterprise, Skills Development Scotland and Highlands and Islands Enterprise. Skills Development Scotland led the development of a service audit report (ISAE 3402) for this service and a report was produced in August 2013 for the period 2012/13. No service audit report was produced for 2013/14 but there have been no major changes to the service and this has been noted in the Governance Statement.

Prevention and detection of fraud and irregularity

31. 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 Scottish Enterprise's overall arrangements for the prevention of fraud are satisfactory, although it should be noted that no system can eliminate the risk of fraud entirely.

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

32. 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

33. 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 the Scottish Enterprise, agree to undertake local work in this area.

34. During 2013/14 the budgetary control and reporting toolkit was used in the IA review and self assessment of the budget processes within SE. As part of the IA report on Review of Customer Excellence and Complaints, the BV toolkit on customer care was also used.

35. Discussions have taken place with the Chief Financial Officer, the Strategy and Economics Director and the Director of Audit regarding a potential performance and best value study covering economic development but this is still at the scoping stage. Discussions in this area are ongoing.

Acknowledgements

36. 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: Key Audit Risks

Key Audit Risks and Associated Audit Work

Audit Risk	Overview of the scope of audit work to address the risks
The Scottish Enterprise Group requires the consolidation of a range of subsidiaries, associates and joint ventures. The size and complexity of the group structure presents an inherent risk to the accuracy of the financial statements, particularly in light of the tight timescales involved in preparing the consolidated financial statements.	We have met with the Group auditors to discuss the procedures for the audit of the group and have reviewed the group boundary assessments. We have undertaken specific work as part of our financial statements audit including receiving appropriate assurances through a component auditor questionnaire.
Significant elements of the financial statements are subject to annual valuation exercises including land and properties, investments and pensions. There is a risk that any subjective judgement/ error in the valuations would have a significant impact on the financial statements.	We have undertaken specific work on the areas of reliance on an expert as part of our financial statements work including the actuary, property valuer, investment fund manager (Maven and in-house staff). We have also reviewed a significant sample of accruals, accrued income and provisions.
A new e-expenses system, GlobalExpense, was introduced across Scottish Enterprise in 2013/14. There is a risk that the control environment is not operating as effectively as planned.	We undertook an initial system review of this area and placed reliance on the work of Internal Audit. Since IA identified a few issues we increased our substantive sample as part of our financial statements audit to include expenses.