Scottish Enterprise

2015/16 Annual Audit Report to Members and the Auditor General for Scotland

25 July 2016

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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 (www.audit-scotland.gov.uk/about/).

Brian Howarth**,** Assistant Director, Audit Scotland is the appointed external auditor of **Scottish Enterprise** for the period 2011/12 to 2015/16.

This report has been prepared for the use of Scottish Enterprise and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in it may be used by the Auditor General in support of her wider responsibilities, including reporting to the Scottish Parliament.

Contents

Key messages

Audit of financial statements	• Unqualified independent auditor's report on the 2015/16 financial statements. • Delays in receipt of property valuations and a revised layout of the Annual Report section of the financial statements affected this year's audit timetable. • The net expenditure changed from £192.5m to £194m (an increase of £1.5m as a result of audit adjustments)
Financial Position	• Operated within its Grant in Aid Resource Limits for 2015/16 underspending by £12m including planned surrender £9.6m of funding to the Scottish Government on request. • Stable short term financial position despite projected overspend in 2016/17, which will be managed down. • Planned Scottish Government review of Scottish Enterprise's roles and responsibilities this summer.
Governance & accountability	• Scottish Enterprise has effective governance arrangements. Overall, there were no material weaknesses in internal control. • Sufficiently open and transparent, but with a single issue of record keeping on one decision affecting a senior staff member. • Scottish Enterprise's Conflict of Interests' Procedures is well-designed but needs operational improvement.
Best Value	• Of fifteen specific performance measures, eight completed the year above their target range with a further one in the top half of its range and six in the lower half. • We reviewed workforce planning arrangements. Current arrangements do not fully align with the recommendations set out in the Audit Scotland report "Scotland's Public Sector Workforce", however new arrangements are being introduced from 2016/17 onwards.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Scottish Enterprise.

2. The management of Scottish Enterprise is responsible for:
   - preparing financial statements which give a true and fair view, in accordance with the relevant financial reporting framework
   - ensuring the regularity of transactions, by putting in place systems of internal control
   - maintaining proper accounting records
   - publishing with their financial statements an annual governance statement and a remuneration report.

3. Our responsibility, as the external auditor, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.

4. An audit of 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 with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.

5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports are summarised at appendix II and appendix III.

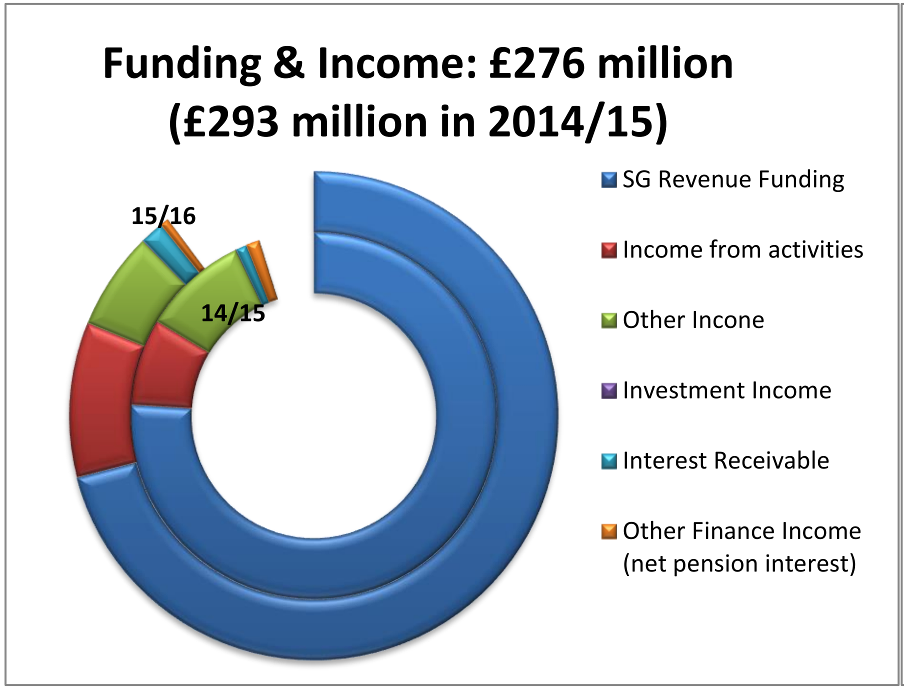
6. Appendix IV is an action plan setting out our recommendations to address the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Scottish Enterprise understands its risks and has arrangements in place to manage them. The Audit Committee should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.

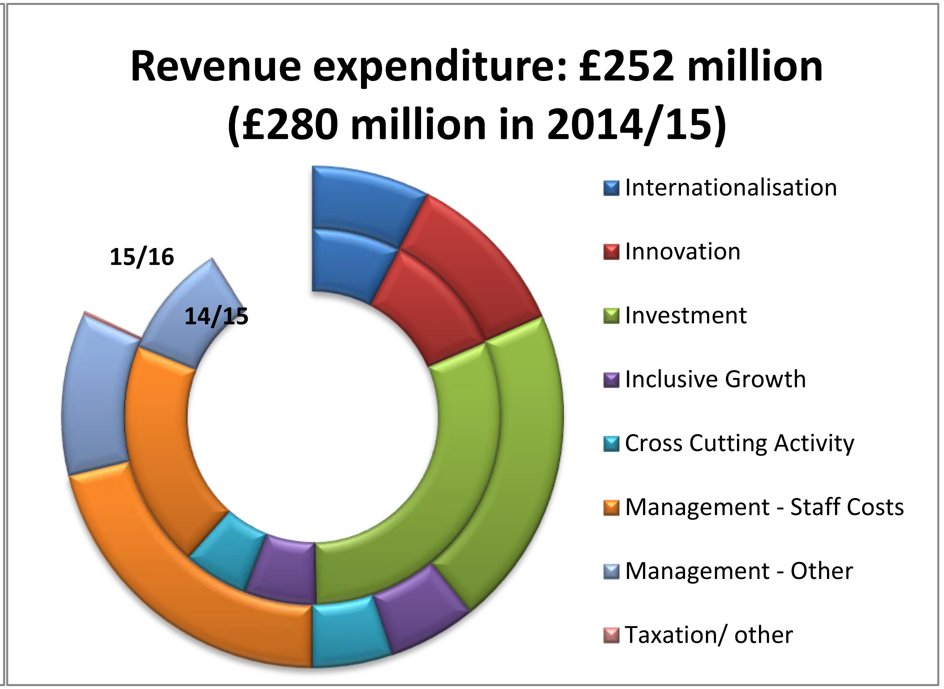
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

9. 2015/16 is the final year of the current five year audit appointment. From 2016/17 the auditor of Scottish Enterprise will continue to be Audit Scotland, however Angela Cullen will replace Brian Howarth as the appointed auditor. Kevin Boyle has been increasingly involved in the audit this year and he will provide continuity into 2016/17.

2015/16 Financial Statements





Funding and Income has decreased by £17m to £276m, mainly due to Scottish Government budgets and European funding (which has fallen by £7.8m due to a delay in the implementation of the 2014-20 European Structural and Investment Funds programme). Anticipated income from land disposals at Carrickstone and Edinburgh did not complete in 2015/16, but are expected to be realised in 2016/17.

Expenditure has decreased by £28m to £252m. This includes Scottish Enterprise achieving £9.6m savings from uncommitted expenditure as expected by the Scottish Government. Investment expenditure (equity investment and loans and renewable energy investment) has been the main area of reduced expenditure and staff costs now form over a quarter of revenue expenditure.

Audit of the 2015/16 Financial Statements

Audit opinions

Financial Statements	• The financial statements of Scottish Enterprise for 2015/16 give a true and fair view of the state of the body's affairs and of its net expenditure for the year. • We confirm that the financial statements have been properly prepared in accordance with the 2015/16 FReM and the requirements of the Enterprise and New Towns (Scotland) Act 1990 and directions.
Regularity	• In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance.
Other prescribed matters	• The part of the Remuneration Report to be audited has been properly prepared in accordance with the Enterprise and New Towns (Scotland) Act 1990 and directions made thereunder by the Scottish Ministers. • The information given in the Performance Report of the Annual Report is consistent with the financial statements.

Submission of financial statements for audit

10. The unaudited financial statements were delayed slightly (two days) and some valuations were based on Rydens mid-year valuation (September 2015) as the year-end valuations were not available.

11. Changes to the FReM and the introduction of IFRS 13 (Fair Value) also led to delays in the provision of information, with the annual report and fair value disclosures provided later than planned. The Parliamentary Accountability and Audit Report was not provided until our on-site fieldwork was completed.

12. Due to these delays, our audit did not finish on 3 June as planned. A number of outstanding items were addressed during the week commencing 6 June and our audit finished on Friday 10 June. These issues adversely affected the audit timescales.

13. The working papers were of a high standard and staff provided good support to the audit team.

14. We understand that a delayed Board meeting date this year will mean that the financial statements will not be signed until 21 July.

Overview of the scope of the audit of the financial statements

15. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Audit Committee on 17 December 2015.

16. 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 any non-audit related services. The 2015/16 agreed fee for the audit was £153,318. We carried out an additional review of Scottish Enterprise's conflict of interest procedures, but no additional fee was charged for this work and the fee remains unchanged.

17. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

18. Appendix I sets out the audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

19. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

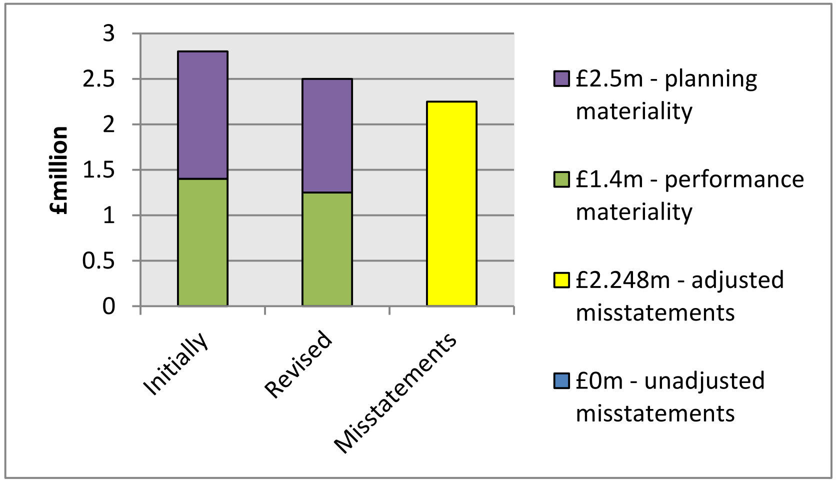
20. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit procedures. We assess the materiality of uncorrected misstatements, both individually and collectively.

21. We summarised our approach to materiality in our Annual Audit Plan. We revised our planning materiality for 2015/16 on receipt of the unaudited accounts to £2.5 million (1% of gross expenditure of £250 million).

22. We also set a lower level, known as performance materiality, when defining our audit procedures. This is determined to ensure that uncorrected and undetected audit differences do not exceed our materiality level. Performance materiality was set at £1.25 million (i.e. 50% of materiality).

23. We report all misstatements greater than £50,000.

Exhibit 1: Overall materiality misstatements



Evaluation of misstatements

24. We identified several misstatements in the unaudited single entity and group financial statements. Management agreed to adjust all misstatements greater than our clearly trivial threshold (£50,000).

25. The total value of adjustments was £2.248 million. This exceeded our overall performance materiality level of £1.25 million and we considered the need to undertake further audit testing. SIB management reviewed all their investment valuations to ensure that there were no further errors between the value included in the financial statements and their valuation reports. Five further issues were found and corrected within the investment valuation. We conclude that, following correction of the investment valuations, there are no remaining errors indicative of systematic errors within the account area or more pervasively within the financial statements.

26. The adjusted errors can be categorised as:

- Delayed information meant that information was not available at the time of the unaudited accounts submission (property valuation £0.3m (paragraph 30), provisions £0.4m (paragraph 34));
- Errors discovered by the audit process (carbon accounting £0.1m (paragraph 31) and investment valuation £1.3m (paragraph 29))
- Errors identified by SE management as the audit progressed (deferred income £0.06m, EU clawback 0.1m (paragraphs 32 and 33))

Significant findings from the audit

27. International Standard on Auditing 260 (ISA 260) requires us to communicate to you significant findings from the audit as detailed below:

- The auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and disclosures.
- Significant difficulties encountered during the audit.
- Significant matters arising from the audit that were discussed, or subject to correspondence with management.
- Written representations requested by the auditor.
- Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

28. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260
Investment valuation 29. In the unaudited accounts, an investment was valued at £1.2m. However, this value was not supported by the SIB valuation report, which valued these at £nil. Management reviewed all their SIB investment valuations and identified a total of six errors, totalling £3.9million. However, this consisted of upwards and downwards adjustments, resulting in a net error of £1.3m to Scottish Enterprise’s net expenditure. Management adjusted the accounts to correctly value the investments.

Significant findings from the audit in accordance with ISA260

Land and Buildings Valuations

30. Scottish Enterprise's property valuer provided the property valuation report late. As a result, the unaudited financial statements did not include up-to-date revaluation information. There were two main issues: Firstly, Scottish Enterprise's property at 236 Broomielaw was revalued downwards, but this revaluation was £0.3 million less in the final valuation report. Secondly, the land and building valuations in the unaudited financial statements were prepared using a draft valuation report, which did not show land and buildings separately. As a result, £2.87m of buildings were reclassified as land following receipt of the final valuation report. Management adjusted the audited accounts to reflect these changes.

Refer Appendix IV, Action Plan 1

Carbon Reduction Commitment Accrual

31. Scottish Enterprise is required to account for the cost of its carbon emissions, and purchased £118,000 of Carbon Allowances in April 2015 for the 2015/16 carbon emission liability. Management recognised this as revenue expenditure. The estimated total cost of Scottish Enterprise's carbon emissions for 2015/16 is £120,000. The FReM requires that carbon allowances purchased in advance are recognised as a current intangible asset, with an accrual recognised for the estimated cost for the financial year. Management adjusted the accounts to recognise an accrual and a current intangible asset.

Reversal of EU Clawback Creditor

32. Management identified an adjustment to the unaudited accounts of £99,000 to the total creditors Year-end reconciliations identified that this had already been deducted from a European grant payment received in November and therefore was recorded initially as a creditor in error. The audited accounts have been adjusted for this error.

Significant findings from the audit in accordance with ISA260

SLF EU Income Adjustment

33. Management identified an issue with deferred income. European income for the Scottish Loans Fund is recognised as deferred income and released to income throughout the funding period. The release rate is based on a percentage of the intervention rate (i.e. the amount invested). An adjustment in the rate applied in prior years meant that too much income (£57,000) had been released from deferred income in error. The audited accounts have been adjusted.

Provisions

34. Management identified two provisions to be added to the unaudited accounts, totalling £380,000. This was due to a delay in making an assessment of ongoing legal cases. The accounts have been adjusted to recognise these provisions.

Future accounting and auditing developments

Code of Audit Practice

35. A new Code of Audit Practice applies to public sector audits for financial years starting on or after 1 April 2016. It replaces the Code issued in May 2011. It outlines the objectives and principles to be followed by auditors. It is part of the overall framework for the conduct of public audit in Scotland.

36. The new Code increases the transparency of our work by making more audit outputs available on Audit Scotland's website. In addition to publishing all annual audit reports, annual audit plans and other significant audit outputs will be put on the website for all audited bodies. This is irrespective of whether the body meets in public or makes documents such as audit committee papers routinely available on its own website.

37. Also, under the new Code, appointed auditors are required to provide conclusions on the four dimensions of wider-scope public audit: financial sustainability; financial management; governance and transparency; and value for money.

Public Sector Internal Auditing Standard

38. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised Public sector internal auditing standard (PSIAS). We will assess Scottish Enterprise's Internal Audit against this revised standard as part of our 2016/17 audit.

Financial management and sustainability

Resource Departmental Expenditure Limit (DEL) underspend £17 million last year £0.1m underspend	Capital Departmental Expenditure Limit (DEL) overspend £5 million last year £0.8m underspend	Total Departmental Expenditure Limit (DEL) Budget underspend £12 million last year £0.9m underspend	Total Net Assets + £49 million
Initial Budget £175m	Initial Budget £55 m	Initial Budget £230m	31 March 2015 £548m
Final Budget £162m	Final Budget £55m	Final Budget £217m	
Actual Outturn £145m	Actual Outturn £60m	Actual Outturn £205m	31 March 2016 £598m
Underspend £17m	Overspend £5m	Under spend £12m	

In addition to its resource budget above, Scottish Enterprise also had a non-cash DEL budget of £26m and an AME budget of £21m.

2015/16 outturn

39. The main financial objective for Scottish Enterprise is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

40. As shown above, Scottish Enterprise underspent its Total DEL by £12m.

Surrender of funds to the Scottish Government

41. Scottish Enterprise surrendered £9.6m of funding to the Scottish Government this year. This consisted of £5m of Scottish Investment Bank investments weren't legally committed and £4.6m of uncommitted expenditure. The £12m total underspend reflects this, as the budget allocation was not adjusted by the Scottish Government.

42. Management advised that the returned Scottish Investment Bank funds didn't have a significant operational impact, as delays in business infrastructure expenditure was used for some of the SIB projects.

2015/16 financial position

43. The financial statements show that Scottish Enterprise:

- has net assets of £598 million, an increase of £50m largely attributable to increased valuations in financial investments, pensions and property, plant and equipment.
- pension scheme remains in a surplus position with assets exceeding liabilities by £72 million.
- operates within its available funding (Total Del in underspent and on an accounting basis, expenditure is £26 million less than funding/ income)
- Incurred negative net cash flows from operations (RDEL allocation of £162m vs £191m net cash outflow from operating activities).
- has an excess of current assets over current liabilities (and this has increased from last year)

44. The First Minister announced on 25 May 2016 that "over the summer, we will also carry out an end-to-end review of the roles, responsibilities and relationships of our enterprise, development and skills agencies, covering the full functions of Scottish Enterprise, Highlands and Island's Enterprise, Skills Development Scotland and the Scottish Funding Council". At this time, we don't believe there is crystallised risk to a change in government policy affecting the body. The total budget for enterprise agencies in 2016/17 is set out in the Budget Act and associated spending plans. (http://news.scotland.gov.uk/Speeches-Briefings/Priorities-speech-Taking-Scotland-Forward-24f8.aspx).

45. **Going concern.** We concur with management's view that the going concern assumption remains appropriate.

Other issues affecting financial position

46. In 2015/16, there was a significant reduction in EU funding from £11.3 million (2014/15) to £3.5 million (2015/16). This was due to a delay in the start of the 2014-20 European Structural Fund. It is anticipated that EU funding will increase in 2016/17, with £5.2 million anticipated in SE's 2016/17 budget.

47. Anticipated income from property disposals reduced due to the postponement of two significant disposals that are now expected in 2016/17.

2016/17 financial outlook

48. 2016/17 is the second year of Scottish Enterprise's current 3 year Business Plan 2015-18.

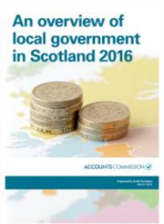
49. Scottish Enterprise's grant in aid allocation has reduced by £17m. However, Scottish Enterprise will obtain £29m of financial transactions monies in 2016/17, which is a new income stream. This is effectively loan financing provided by HM Treasury, which will

require to be repaid in due course. It will be used to fund equity investment and debt finance.

Financial Planning

50. In June 2014, Audit Scotland reported on [Scotland's public finances] and identified that public bodies "face increasingly difficult choices in reducing spending while maintaining service standards and meeting rising demand". The report identified that financial planning improvements were required by public bodies.

51. In the local government overview report in March 2016, Audit Scotland set out some key questions, which can apply across the Scottish public sector. These questions provide a framework for our assessment of financial planning in Scottish Enterprise (see below).



Assessing financial planning

How fully do our financial plans identify estimated differences between income and expenditure (budget shortfall)?
52. Scottish Enterprise's Business Plan 2016-17 includes a financial forecast for 2016/17. There is a £17.3m reduction to the baseline budget anticipated. The Board approved a balanced budget, but as at April 2016, there is a £3.4m overspend forecast. The £3.4m projected overspend is in line with performance in prior years and reflects established pattern of over-commitment in the early part of the year in order to manage slippage in the management of investments and funding requests. Management anticipates that the 2016/17 outturn will be within budget. Activity is flexed within its budget envelope and Scottish Enterprise undertakes a mid-year review in September to rebase its budget, taking into account changes in priorities for spending and to manage uncommitted investments/ expenditure to achieve budget. This is similar to a number of other public bodies that can manage a significant element of its overall budget through approval of applications of projects.
What options do we have to address this budget shortfall for example redesign services or use reserves? How big is the remaining funding gap after we implement our selected options? What actions are we taking to close any remaining funding gap?

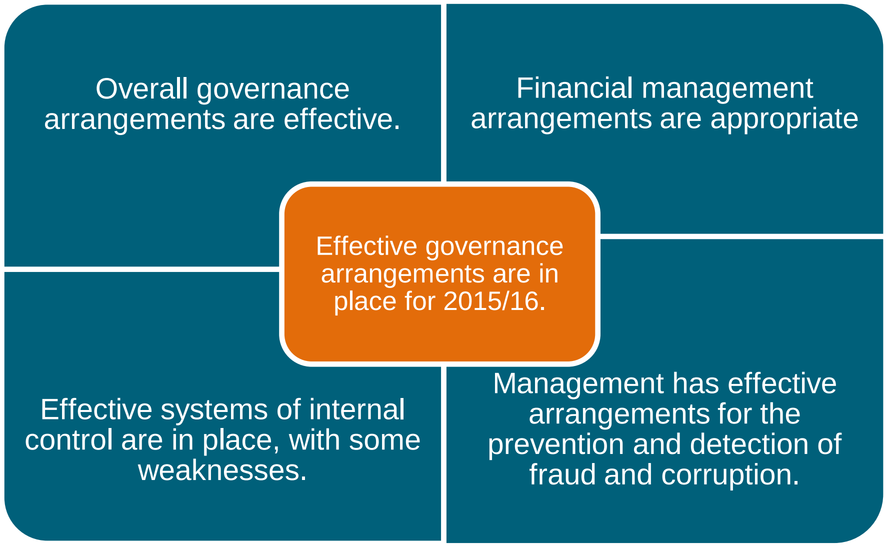
53. As noted above, activity would be managed within the available budget envelope. A recurrent funding gap doesn't exist, but activity would be reduced in line with budget availability. This becomes increasingly difficult if committed expenditure becomes a relatively larger element of the total budget. For example staff costs now form over 25% of revenue expenditure due to total budget reductions.

Do we have a long-term financial strategy covering at least five years that accounts for future pressures? Is our five-year strategy supported by detailed financial plans covering a minimum period of three years? How well do our financial plans set out the implications of different levels of income spending and activity? How does our financial strategy link to our vision for the future?

54. Scottish Enterprise currently prepares a three-year business plan from 2015/16, which includes financial forecasts for income and expenditure. 2015/16 was the first of the current three-year Business Plan. Supporting financial plans over a longer period are not established.

Appendix IV – Action Plan No. 2

Governance and transparency



Corporate governance

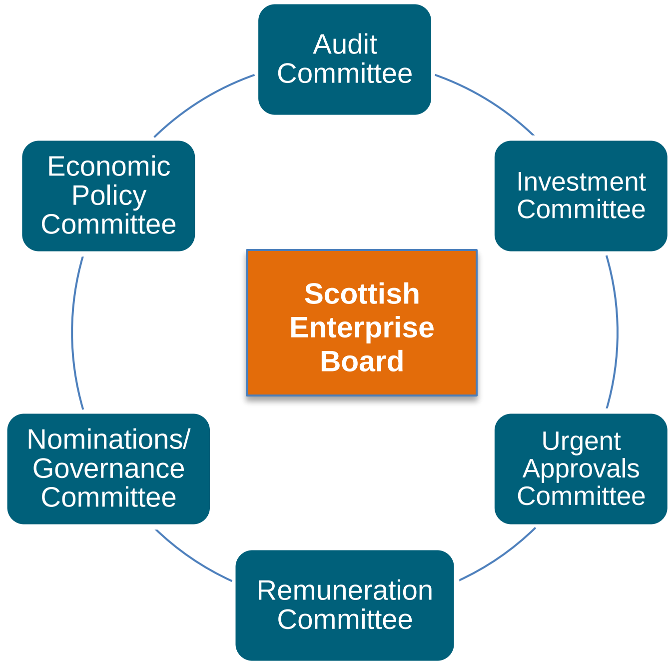
55. The Board and Accountable Officer are responsible for establishing arrangements for ensuring the proper conduct of the affairs of Scottish Enterprise and for monitoring the adequacy of these arrangements.

56. Scottish Enterprise is managed by a board of non-executive directors and is accountable through Scottish Minsters to the Scottish Parliament. The Board's Chair and non-executives are appointed by Scottish Ministers. Three new members were appointed to the Board in January 2016:

57. We concluded that Scottish Enterprise has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

58. The Board is supported by a number of standing committees.

Exhibit 2: Scottish Enterprise Governance Structure 2015/16



59. The Board met ten times during the year and the Audit and Investment committees quarterly. The other sub-committees met on a regular basis throughout the year to consider relevant matters.

Financial management

60. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
    - The Chief Financial Officer has sufficient status to be able to deliver good financial management
    - standing financial instructions and standing orders are comprehensive, current and promoted within the body
    - reports monitoring performance against budgets are accurate and provided regularly to budget holders
    - monitoring reports do not just contain financial data but are linked to information about performance
    - Audit Committee members provide a good level of challenge and question significant variances.

61. Based on our accumulated knowledge, our review of Board papers and through our attendance at the Audit Committees, we conclude that Scottish Enterprise has strong financial management arrangements in place.

Transparency

62. The Scottish Government's On Board guidance (http://www.gov.scot/Publications/2015/04/9736/0) for board members of public bodies was updated and reissued in April 2015. On Board states that boards should demonstrate high standards of corporate governance at all times including openness and transparency in decision making. It recommends boards should consider:
    - holding an annual open meeting
    - holding board meetings in public unless there is a good reason not to
    - publishing summary reports and/or minutes of meetings
    - inviting evidence from members of the public in relation to matters of public concern
    - consulting stakeholders and users on a wide range of issues
    - making corporate plans and the annual report widely available.

63. Audit Scotland also believes in transparency of financial reporting within the Annual Report and Accounts including:
    - A clear reconciliation between expenditure and the outturn against Scottish Government Resource budgets.
    - Identification and explanation of any significant movements in budget during the year.

64. Scottish Enterprise makes available a range of information on its website, including the 2015-18 Business Plan and the annual report and accounts.

65. The discussions that typically take place at board meetings are often commercially sensitive, and are therefore held in private. However, summarised minutes of all board meetings are made available on the website.

Settlement Agreement

66. In our 2011/12 Annual Report, we identified issues with the voluntary severance scheme in that year. This included recommendations about scrutiny and approval. We identified 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

67. This year, 2015/16, a member of the Executive Leadership Team reached a settlement agreement with Scottish Enterprise, which included a payment of £196,525. We confirmed that this was subject to Scottish Government approval in May 2015 and included a business case based on a restructure within the Executive Leadership Team which led to the reduction of one post through the realignment of responsibilities and the amalgamation of divisions. An annual salary saving of £120,000 per annum was identified as a result of this restructure.

68. We also requested evidence that this restructure/ settlement was discussed/ approved by the Scottish Enterprise Board or Remuneration Committee, We understand from discussion with senior officers and references in e-mails that this was discussed at a private session of the Board in January 2015 and a contemporaneous note of this discussion was not kept.

69. Overall we conclude that Scottish Enterprise is sufficiently open and transparent, but noted an issue relating to the record keeping from a private board session regarding a decision affecting a senior staff member.

Internal control

70. No material weaknesses in the accounting and internal control systems were identified during the 2015/16 audit which could adversely affect the organisation's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

71. However, during our controls testing, we identified the following control weaknesses.

72. **Evidence of Timely Review:** There was no evidence of timely review for a sample of construction invoice exception reports and a payroll audit report sampled. As a result, we substantively tested a sample of changes to the payroll and construction invoices to confirm that the expenditure was valid (occurrence) and accurate. No issues were identified.

73. **Expenses:** Internal Audit identified weaknesses in the controls operating over the expenses system, including failure to comply with Scottish Enterprise's Expenses Policy and weaknesses in controls regarding the checking of overseas staff's travel expenses. As a result, we substantively tested a sample of expenses during our financial statements audit. No issues were identified.

74. **Debt Management:** During our controls testing, we found that there was a delay in the review of aged debt during December, and no debt write-offs had occurred in the first 9 months of the financial year. During our financial statements audit, we substantively tested Scottish Enterprise's bad debt write-offs and the provision for doubtful debts. No issues were identified.

Internal audit

75. Internal Audit provides the Audit Committee and Accountable Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of Internal Audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on Internal Audit work where possible.

76. As part of our risk assessment and planning process, we assessed Scottish Enterprise's Internal Audit department. We concluded that they operate in accordance with the Public Sector Internal Audit Standards (PSIAS). This enabled us to place planned reliance on the work of internal audit, in terms of their work on Expenses, Investments and Key Project Controls. The Internal Audit Plan for 2015/16 was delivered.

Internal Audit Review of European Funding

77. The Scottish Government Internal Audit team (SGIA) identified errors in its 2013 and 2014 audits of Scottish Enterprise's expenditure relating to EU Structural Funds. In June and July 2015, Scottish Enterprise Internal Audit carried out a review of the circumstances and action plans put in place to address identified weaknesses.

78. We reviewed Scottish Enterprise Internal Audit's work to consider the adequacy of the resulting action plans and its proposals for changes to processes.

79. We found that the reviews by Internal Audit adequately addressed the historic issues raised and has taken appropriate action to address the weaknesses in future claims, including assigning additional resources and undertaking early work in advance of the 2015 audit.

Disaster Recovery (ICT)

80. There was significant change in Scottish Enterprise's IT arrangements during 2015/16. Since July 2015, Scottish Enterprise has moved from a single IT service provider, ATOS, to six separate providers. In March 2016, Internal Audit identified weaknesses:

- There is no approved Disaster Recovery Plan in place and there has been no disaster recovery testing in the past 12 months. This is particularly critical given the transition to six suppliers.
- Service level agreements have been agreed with the new suppliers. These include arrangements for disaster recovery, However, Internal Audit found that these have been drafted by the suppliers, with no validation by SE system users.

81. Management has confirmed that a Disaster Recovery Plan was being developed at the time of Internal Audit's review and the recommendations proposed by Internal Audit will be adopted.

Refer to Appendix IV, Action Plan 3

Oracle System

82. Scottish Enterprise is currently replacing its financial, payroll, human resources and expenses systems with Oracle. This is a shared services arrangement with Scottish Natural Heritage and the Scottish Legal Aid Board.

83. There have been significant delays in the introduction of the Oracle system. Due to these delays, the Oracle Project Board within Scottish Enterprise has suspended the introduction of the Oracle system and appointed an external consultant to review the introduction of this new system. Management is currently awaiting the outcome of this review before they decide whether to proceed.

84. Management has decided not to renew the licence for its current expenses software, which it planned to replace with Oracle i-expenses. However, due to the delays, Scottish Enterprise has reverted to using its previous expenses system using manual forms and spreadsheets.

Managing ICT

85. The difficulties in managing ICT programmes in both the public and private sector are well documented. In August 2012, the Auditor General for Scotland published a report focusing on three central government ICT projects that had encountered difficulties. The report looked at the factors that contributed to the problems and whether any lessons could be learned for public bodies undertaking ICT programmes in the future. More recently "Managing ICT contracts in central government" reviews the progress that the Scottish Government and central government bodies have made against the recommendations in our previous report on managing ICT contracts. We recommend to Scottish Enterprise the findings from our work in this area as part of the review of the Oracle project, particularly appendix 1 in our first report "Managing ICT contracts".

Arrangements for the prevention and detection of fraud

86. Scottish Enterprise is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We reviewed and reported on these arrangements and have concluded that there are effective arrangements for the prevention and detection of fraud.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

87. 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.

88. Scottish Enterprise has in place a range of measures designed to maintain standards of conduct including separate codes of conduct for board members and employees. There are established procedures for preventing and detecting corruption including annual reviews of Standing Financial Instructions and Standing Orders.

Register of Interests Review

89. Given the nature of its business, Scottish Enterprise requires all staff and board members to complete annually a register of interest declaration to highlight any circumstances which may pose a conflict of interest. This annual process demonstrates best practice.

90. We reviewed Scottish Enterprise's conflict of interests' procedures in January 2016, following a request from the Board. We identified the following issues:

- the last organisation-wide request for staff to complete a conflict of interests' declaration was in August 2014. Management aims to complete this process annually, but this has been postponed due to delays in the introduction of the new Oracle HR system.
- HR performs a quality check on conflict declarations and management plans. However, this last took place in March 2015, with no further review of management plans received since then.
- HR last updated the conflict database in November 2015. We reviewed this and found that a large number of declared conflicts of interests have still not been resolved. Of the 186 staff who declared a potential conflict of interests, 69 cases are outstanding, awaiting a response from the line manager to confirm whether the conflict can be managed and whether a management plan is needed.

91. As part of our financial statements audit in May/June 2016, we revisited the issues above. We found that there was no evidence that 14 of the 69 outstanding cases had been addressed. Management advised that the Leadership Team reviewed the 69 outstanding cases to ensure that any potential conflict was dealt with appropriately.

92. However, due to delays in the introduction of the new Oracle HR System (outlined above), Scottish Enterprise has not run a new request for all staff to update their conflict of interests' declarations. This is due to take place annually, but hasn't been done for nearly two years. Management plans to launch a new request for conflicts of interests' declarations to be updated. This will begin in June 2016 using the existing manual systems and will address the 14 outstanding cases referred to above.

Refer to Appendix IV, Action Plan 4

Correspondence referred to the auditor by Audit Scotland

93. As part of our wider Code responsibilities we are required to consider issues raised and follow these up as part of our risk based approach to the audit if they fall within our remit.

94. As reported in our 2014/15 Annual Audit Report, a number of correspondents wrote to Audit Scotland in 2014 and 2015 identifying concerns with payments made (£253,000) from Scottish Enterprise Dunbartonshire (SED) in December 2006 to cover part of £1 million abnormal site costs associated with a development. In a related agreement between SED and Lennoxtown Initiative in August 2007, SED agreed that the funding would be paid through Lennoxtown Initiative.

95. In November 2015, Audit Scotland's Report on the Lennoxtown Initiative was published. This reported on the wider review of the role of public sector organisations in Lennoxtown Initiative. A copy of this report is available on our website.

Best Value

Arrangements for securing Best Value

96. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.

97. During 2015/16 Scottish Enterprise conducted a risk management review in accordance with its Risk Management Policy. This included an assessment of performance using Audit Scotland's Best Value Toolkit: Risk Management. Management identified that Scottish Enterprise has appropriate risk management arrangements in place, although some areas for improvement were identified, which will be addressed during 2016.

Performance targets 2015/16

98. Scottish Enterprise's 2015/16 Business Plan includes fifteen specific performance measures with all being achieved. Eight completed the year above their target range with a further one in the top half of its range and six in the lower half.

99. Nine of the twelve milestones set out in the 2015/16 Business Plan have been met. The remaining three are contribution to local outcome plans; productivity plans for tourism, food & drink and construction; and a revised approach to tackling inequality, including how we measure success.

Performance management

100. Scottish Enterprise's Business Plan for 2015-18 has been updated for 2016/17. The Business Plan covers four main themes, which have been established as the main drivers of growth in the Scottish economy: innovation, internationalisation, investment and inclusive growth. This is in line with Scotland's Economic Strategy, published by the Scottish Government in February 2015 and reflects the proprieties and actions outlined in the Scottish Government's Programme for Government.

Local performance audit reports

Workforce Planning

101. Audit Scotland published a report on *Scotland's Public Sector Workforce* in November 2013. We carried out a follow-up audit at Scottish Enterprise in February and March 2016, based on the recommendations in the 2013 report.

102. Scottish Enterprise's current arrangements do not fully align with the recommendations set out in *Scotland's Public Sector Workforce*. Instead, the Executive Leadership Team considers workforce composition to ensure the organisation has the capacity and capability to meet the future business priorities taking into account future skills needs, gaps and challenges. These discussions are formalised as part of the annual budget process before the start of each financial year and during the mid-year budget rebasing. Resourcing discussions are held as required throughout the year.

103. During 2015/16 Scottish Enterprise has been developing its workforce planning arrangements, with new procedures to be introduced. This will allow Scottish Enterprise to take a longer-term strategic view on its workforce. The new arrangements will be managed by the Leadership Group, who will consider:

- The strategic objectives and business functions of the business unit.
- The trends, future influences and challenges for business units and workforce composition.
- The knowledge, skills and abilities of current employees
- future gaps/surpluses in staffing and skills levels.

104. We identified that Scottish Enterprise has sound arrangements for succession planning and staff training.

105. We identified in 2011/12 that Scottish Enterprise's Redundancy Policy required to be reviewed. Scottish Enterprise is currently in discussions with Scottish Government regarding proposed changes to this policy and discussions with trade unions have been suspended during this period.

National performance audit reports

106. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, a number of reports were issued as outlined in Appendix III.

Supporting Scotland's economic growth: The role of the economic development agencies

107. Audit Scotland is nearing the end of its review of economic development within Scottish Enterprise and Highlands and Islands Enterprise. These enterprise bodies have a specific remit to generate economic growth across Scotland. This report is considering how enterprise bodies work with the Scottish Government to determine economic priorities and deliver outcomes in the National Performance Framework. This will also assess how well the enterprise bodies work with partners to plan, manage and evaluate economic development activity. The report and its findings are expected to be published in the summer.

Appendix I: Significant audit risks

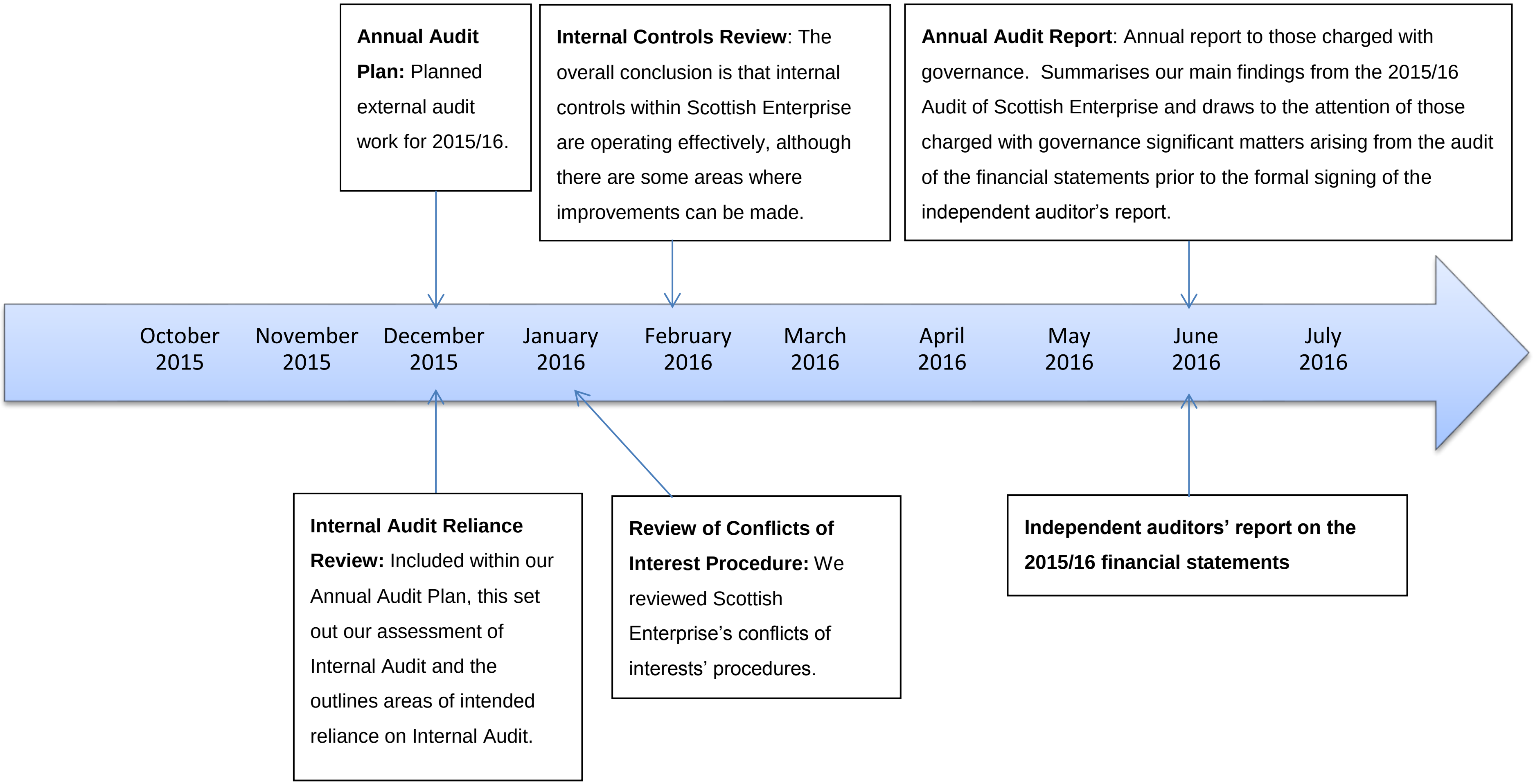
The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
Income: Auditing standards (ISA 240 The auditor's responsibility to consider fraud in an audit of financial statements) requires auditors to presume a risk of fraud where income streams are significant. In 2015/16, Scottish Enterprise is expected to receive around £74.4 million from other sources, including property income, property disposals and other business income. *The extent of income means there is an inherent risk that income could be materially misstated.*	• We will perform controls testing over the accounts receivable system to confirm that the revenue recognition procedures are working effectively. • We will perform substantive testing of income to ensure that income has been recognised appropriately.	Our controls testing did not identify any issues with Scottish Enterprise's revenue recognition procedures. We substantively tested a sample of income transactions, however no issues were identified.

Audit Risk	Assurance procedure	Results and conclusions
Management Override of Controls: There is an inherent risk that management could manipulate accounting records and prepare fraudulent or biased financial statements by overriding controls that otherwise appear to be operating effectively.	• Detailed testing of journal entries. • Review of accounting estimates. • Evaluation of any significant transactions that are outside the normal course of business.	We did not identify any issues as a result of our audit work that would indicate management override of controls affecting the year-end position.
Valuations: Significant elements of the financial statements are subject to annual valuation exercises that rely on the provision of valuations by management experts, including land and properties, investments and pensions. There is a risk of error in valuation assumptions used by the actuary, investment manager and valuer.	• Our audit work will consider the nature, scope and assumptions made in these valuations to enable us to place reliance on management's experts in accordance with ISA 5000. • Detailed substantive testing of a sample of investment valuations during the financial statements audit.	We reviewed the valuations of land & properties, pensions and investments, which were prepared by management's experts. We found these judgements to be sound and, as such, were able to place reliance on the experts' valuations. However, there were delays in the provision of the property valuation reports, meaning that some property revaluations were not processed in the unaudited accounts. We found one error in the investment valuation. These were adjusted in the audited accounts. We also identified an error in the valuation of an investment. SIB reviewed all of the investment valuations and identified a total of six investment errors. These were adjusted in the audited accounts.

Audit Risk	Assurance procedure	Results and conclusions
Investment write offs: The level of write off has increased at a steady rate over the past 4 years with indications that 2015/16 will remain comparable to 2014/15. *There is a risk that amounts written off have not been subject to approval in accordance with procedures and are not disclosed appropriately in the financial statements.*	• Our audit work will test a number of significant write offs to ensure that they have been approved in line with procedures and that they have been correctly disclosed and reflected in the financial statements.	We substantively tested a sample of investment write offs. We found that the approval process for write offs had been followed by Scottish Enterprise. The accounting treatment and disclosures were satisfactory.

Appendix II: Summary of local audit reports 2015/16

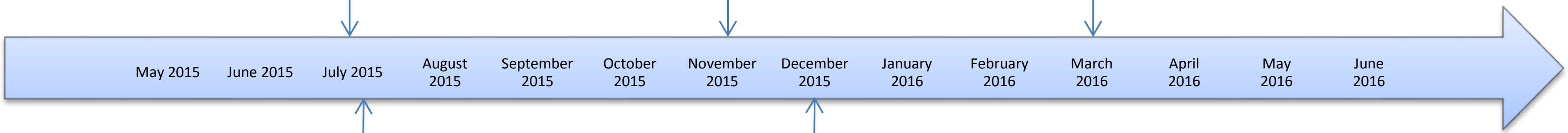


Appendix III: Summary of Audit Scotland national reports 2015/16

Renewable Energy Impact Report:
Follow-up of our 2013 Renewable energy report. Examined investment in renewable energy by the SG, SE and HIE renewable energy, and evaluated what has been delivered.

Conclusion of Issues Relating to Lennoxtown Initiative: Report on our review of the Lennoxtown Initiative and the role of public bodies, including SE.

Managing ICT Contracts in Central Government: an Update
This reviewed the progress that the Scottish Government and central government bodies had made against the recommendations in our previous report.



Scotland's Public Sector Workforce – Impact Report
This assesses the impact made by our 2013 report, 'Scotland's public sector workforce' published on 28 November 2013 and the related good practice guide. This reviewed how the devolved public sector managed changes to its workforce to ensure that it continued to deliver service priorities, while helping bodies to deal with financial pressures and make savings.

Implementing the Scotland Act 2012: an update: This report assessed how effectively Revenue Scotland implemented, and is collecting, the two devolved taxes introduced in April 2015. It also examined how the Scottish Government is working with HM Revenue and Customs to prepare to introduce the Scottish rate of income tax in April 2016.

Appendix IV: Action plan

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	30	**Issue:** The Property Valuer's Report was provided late. This resulted adjustments to the unaudited financial statements and delays in providing information. **There is a risk that the accuracy and delivery of the financial statements is affected.** **Recommendation**: Management should ensure that the property valuation reports are received in sufficient time to allow land and buildings revaluations to be reflected accurately in the unaudited financial statements.	The delay was in part due to a change in independent valuers this year. Management will conduct a full review and put in place measures to avoid similar delays in future years.	Chief Financial Officer, September 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
2	54	**Issue:** Scottish Enterprise currently prepares budgets for its 3 year business plan. This covers the next two financial years. A stable short term operational budget is maintained based on managing activity and transaction flow as the year progresses. **We recommend that a long term financial strategy (5 years +) supported by clear and detailed financial plans (3 years +) is prepared. This is increasingly important as the ability to manage budget outturn through controlling uncommitted activity is reducing as elements such as staff costs represent a larger proportion of total spend. Plans should set out scenario plans (best, worst, most likely); with a much clearer assessment of the impact of budget assumptions on activity and any residual risks.**	Scottish Government funding cycles have historically been between 1 and 3 years. The nature of our expenditure allows for reasonably quick amendments to budgets if required. However, management agrees to prepare a 5 year financial strategy to test the impact of potential scenarios.	Chief Financial Officer, March 2017

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3.	81	**Issue** Scottish Enterprise does not have a Disaster Recovery Plan in place. There has been no disaster recovery testing since the transition to six IT suppliers. The six suppliers in Scottish Enterprise's IT framework have outlined disaster recovery plans in their service level agreements. However, Scottish Enterprise has not reviewed these to determine whether they are adequate for their purposes.	Plans are now in place to perform a rolling programme of Disaster Recovery testing for key business systems. Initial testing will be completed in 2016/17 and the plan will be refined thereafter.	Chief Financial Officer, March 2017
4.	92	**Issue** Scottish Enterprise's conflicts of interests' policies require staff to complete an annual declaration of interests. However, an organisation-wide request for staff to complete conflict declarations has not been undertaken since August 2014. **Recommendation**: Scottish Enterprise should undertake an organisation-wide conflict of interest process annually. The process should be completed timeously with appropriate action taken to manage and address identified conflicts.	Scottish Enterprise postponed the roll-out of the 2015/16 conflicts of interests' process for all staff, as it planned to use the new Oracle HR system to manage this. However, due to delays in introducing Oracle, this has not yet taken place. Management plans to introduce a new request for all staff to submit a conflict of interests' declaration in line with the Staff Code of Conduct during summer 2016.	Chief Financial Officer, September 2016