# Scottish Enterprise

## Management Report 2017/18

AUDIT SCOTLAND

**Prepared for Scottish Enterprise**

June 2018

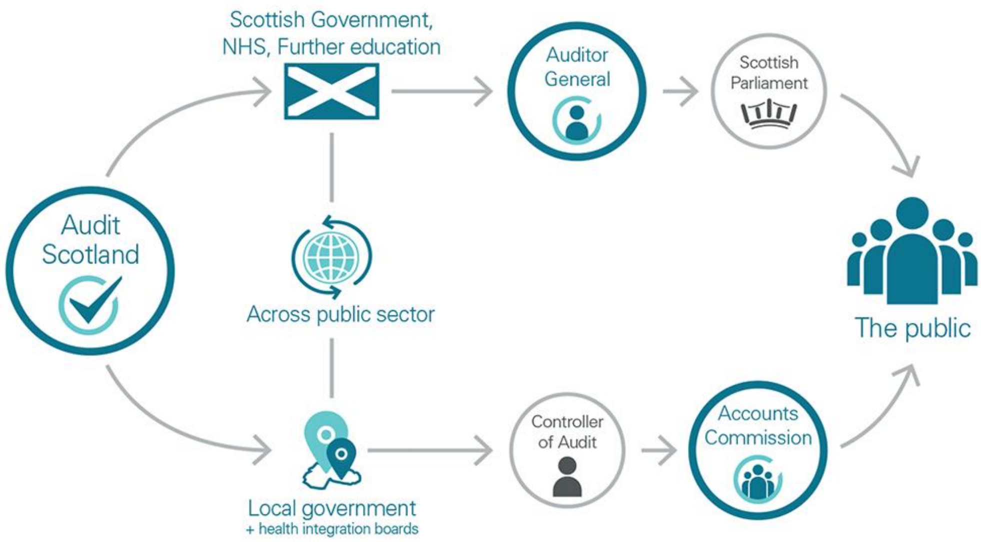
# Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non–executive board chair, and two non–executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.




# About us

Our vision is to be a world–class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

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# Audit findings

## Introduction

**1.** This report summarises the key issues we identified during our interim audit at Scottish Enterprise. This included testing of key controls to gain assurance over the processes and systems used in preparing the financial statements. The results of this testing will inform our approach to the 2017/18 financial statements audit.

**2.** Our responsibilities under the Code of Audit Practice require us to assess the system of internal control put in place by management. We seek to gain assurance that Scottish Enterprise:

- has systems of recording and processing transactions that provide a sound basis for the preparation of the financial statements
- has systems of internal control that provide an adequate means of preventing and detecting error, fraud or corruption
- complies with established policies, procedures, laws and regulations.

**3.** Our Annual Audit Plan referred to the wider scope of public audit, wider dimension audit risks and our planned approach. As part of our audit work to date we reviewed and assessed selected aspects of the financial management of property disposals. We also reviewed Scottish Enterprise's revised approach to recording and monitoring conflicts of interests.

## Conclusion

**4.** We identified two matters for attention relating to key controls within the main financial systems. These are summarised in Exhibit 1 (items 1 and 2) below. The management actions taken and proposed will further strengthen the control environment. We shall carry out additional work where appropriate to enable us to take planned assurance for our audit of the 2017/18 financial statements.

**5.** We found that Scottish Enterprise's procedures for managing property disposals were largely in accordance with the Scottish Public Finance Manual (SPFM). We also found that its arrangements for recording and monitoring conflicts of interests represent good practice. We identified some areas where there is scope for further development. These are also set out at Exhibit 1 (items 3 and 4).

## Work summary

**6.** Our 2017/18 testing covered key controls in a number of areas including bank reconciliations; payroll validation and exception reporting; authorisation of journals; change of supplier bank details; IT access controls; budget monitoring and control; feeder system reconciliations and investments.

**7.** In accordance with *ISA 330: the auditor's response to assessed risk*, our audit judgements are based on current year testing of controls and, where appropriate, prior year results. Our risk-based audit allows us to take a three-year cyclical approach to controls testing. This enables us to place reliance on previous years' audit work where controls remain unchanged and no significant weaknesses had been identified.

**8.** Where possible we place reliance on the work of internal audit, to avoid duplication of effort. We reviewed internal audit's work on investments, budgetary control and contract management. We were able to place appropriate reliance on aspects of internal audit's work to support our audit conclusions.

**9.** Our wider dimension audit work focussed on Scottish Enterprise' property disposal procedures and its arrangements for overseeing conflicts of interest.

**10.** The key control and wider scope risks identified during the interim audit are detailed in Exhibit 1. These findings will inform our approach to the financial statements audit, where relevant.

**11.** The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.

**12.** Any weaknesses identified represent those that have come to our attention during the course of normal audit work and therefore are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to Scottish Enterprise.

## Review of property disposals

**13.** Our 2017/18 Annual Audit Plan noted that a balanced budget relies on Scottish Enterprise achieving certain income targets, including income from property disposals.

**14.** Scottish Enterprise's Framework Agreement with the Scottish Government requires Scottish Enterprise to comply with the SPFM. We reviewed selected aspects of Scottish Enterprise's arrangements for property disposals and considered whether they complied with the SPFM.

**15.** A Property Portfolio Asset Management Plan (PPAMP) was agreed in October 2016. This plan reflected management's review of Scottish Enterprise's property holdings and outlined a 3-year property disposal programme.

**16.** The PPAMP split the property portfolio into the following main categories:

- **Strategic Assets:** these make a direct contribution towards achieving Scottish Enterprise's objectives in a key sector or thematic plan. These assets are rarely available for sale.

- **Economic Assets:** these provide a pipeline of sites/premises that facilitate the growth of Scotland's company base and support inward investment.

- **Legacy Assets:** these do not directly contribute business plan objectives beyond the ability to generate future capital receipts.

**17.** In May 2017, an update to the Executive Leadership Team identified assets to the value of £94m planned for disposal across three years, 2017/18-2019/20. As part of this review, Scottish Enterprise appraised these non-strategic assets to determine whether they would benefit from additional investment, such as application for planning permission, to maximise their ultimate resale value.

**18.** Scottish Enterprise has guidelines for the disposal of properties, which are largely in accordance with the SPFM requirements. We noted that:

- Scottish Enterprise has reviewed its property holdings to ensure that they are kept to a minimum and this is kept under regular review as part of the current disposal plan

- professional selling agents are appointed to value and market the properties. An independent valuation is obtained prior to marketing

- property disposals are approved by the Board, Executive Leadership Team or Single Approvals Group, as required by the Scheme of Delegated Authority

- the preference is for an open marketing campaign. Assets disposed off-market require prior approval by the Chief Executive, regardless of value.

**19.** We identified the following matters for development which, if addressed, would confirm, or result in, closer alignment with the SPFM requirements.

- The SPFM requires property disposal programmes to be included in an organisation's Strategic Plan. There is no reference to the PPAMP in Scottish Enterprise's 2017/18 Business Plan. Management advised that the linkage is via the Business Infrastructure Operating Plan. We acknowledge that the wider Enterprise and Skills Review has delayed strategic longer-term planning at Scottish Enterprise.

- The SPFM requires public bodies to advertise surplus properties with other public bodies in a process called 'the Trawl'. Management believes that Scottish Enterprise is largely exempt from the Trawl if a disposal relates to its economic development objectives. We noted Scottish Government guidance which suggests the exemption from the Trawl may not apply to disposal of surplus property to generate capital receipts. Management has agreed to seek clarification from the Scottish Government Property Team.

- Scottish Enterprise appoints external valuation and marketing agents to assist with property disposals. This is often the same firm. The SPFM requires management oversight of staff and advisors, with a clear separation of responsibilities between the valuation and disposal process. Management is of the view that external agents have appropriate internal arrangements to achieve segregation of duties. However, no specific assurances are obtained from the agents on this point.

**Refer to Exhibit 1, Issue 3**

**20.** We concluded that there are effective internal arrangements to monitor progress against the 2017/18 disposals target, which include:

- quarterly meetings between Finance and Business Infrastructure

- reporting to the Board and the Executive Leadership Team through monthly Financial Performance Reports

- the appointment of a Senior Responsible Officer (SRO) for the Business Infrastructure property disposals programme, who closely monitors disposal activities.

**21.** In 2017/18, Scottish Enterprise disposed of property to the value of £26m against the 2017/18 target of £23.2m. We tested a sample of five disposals that took place in 2017/18, with a combined value of £21.9m (89% of disposals). We confirmed that these were disposed of in accordance with Scottish Enterprise's internal guidelines and the SPFM requirements.

**22.** Scottish Enterprise has prioritised the disposal of high-value, attractive and more marketable properties in the first year of the PPAMP. Management recognises that it will become increasingly difficult to dispose of less marketable properties as the three year disposal project progresses.  They also recognise that this may affect the achievement of the planned income target and consequently Scottish Enterprise's capital budget in future years.

**23.** One of our sample selected (£10m) related to a sale of a strategic asset. The asset was not included within the initial disposal listing as it was categorised as a strategic asset in the PPAMP and therefore not originally intended for sale.  The Board approved the disposal on the basis that the purchaser agreed to fulfil

Scottish Enterprise's development objectives and Scottish Enterprise will continue to have a role in the delivery of the expected economic outputs from the initial investment.

**24.** Scottish Enterprise re-values its properties every six months. However, the initial disposal plan is not updated to reflect these regular revaluations. It would be useful to maintain a rolling analysis of performance against the initial disposal target across the three-year period, taking into account the effect of valuations. This would help demonstrate value for money, and the achievement of the disposal targets. Management have advised that the sales forecast spreadsheet will be updated at each asset valuation date (twice yearly) to reflect the revised asset value. This spreadsheet now covers a three-year period (by financial year). In-year progress will be tracked on a quarterly basis (against the original forecast) in conjunction with Finance.

**25.** Scottish Enterprise recognises the impact of disposing of rental-generating properties on its overall financial position. In May 2017, Scottish Enterprise estimated that rental income would reduce from £7.4m in 2017/18 to £1.2m by 2019/20. The reduction in recurring rental income taken together with the one-off nature of income from property sales, will require ongoing dialogue with the Scottish Government in relation to future funding levels. We acknowledge that Scottish Enterprise review income projections on a regular basis. Management has advised that close working will continue between the Property Management, Disposal and Finance teams together with ongoing discussions with the Scottish Government to ensure the impact of the sales programme is fully factored into any future income/funding projections.

## Review of conflict of interests framework

**26.** In our Annual Audit Plan, we identified a risk of fraud over income and expenditure. Auditing standards and the Code of Audit Practice require auditors to consider this risk in all of our audits. As part of our work to address this risk, we reviewed and assessed the operation of Scottish Enterprise's conflict of interests procedures.

**27.** Scottish Enterprise has a well-established process for recording and monitoring potential conflicts of interests for staff and board members. For example:

- the Staff Code of Conduct requires all staff to make an annual conflict of interests declaration. Staff are also required to declare interests as soon as they become aware of them. Staff are required to register their own conflicts and those of friends and family.

- people managers are required to review declared conflicts timeously and determine whether a management plan is required to address the declared conflicts.

- board members are required to register their interests on Scottish Enterprise's website within 30 days. They are required to verbally declare their interests, including those of family and friends, at Board meetings and excuse themselves from discussions where a conflict arises.

**28.** A new online system for recording and monitoring conflicts of interests was implemented in January 2018 and we reviewed progress as part of our interim work. All staff were required to declare conflicts of interests by 8 February 2018. People managers were required to approve a management plan for declared conflicts by 22 February and the Leadership Team were due to review and approve all management plans by 9 March.

**29.** We reviewed this process and, as at 12 March, we found that:

- 1,134 out of a possible 1,150 forms had been submitted (98.6% completion rate). The exercise excluded staff on long-term sick leave, maternity leave and secondment. We tested a sample of five individuals in this category and confirmed that there were justified reasons for these employees not having completed the declaration

- There were 264 conflicts declared. We tested a sample of 15 conflict declarations and confirmed that in all instances, an appropriate management plan was in place to mitigate the conflict
- 27 out of 264 (10.2%) conflicts declared were awaiting review by people managers
- weekly reminders are being sent to senior management to remind them of their responsibilities until the process is 100% complete and all declarations are approved.

**30.** Management should ensure that the outstanding forms, conflict declarations and related management plans are actioned. Management should also ensure that this process takes place annually, in line with the Staff Code of Conduct.

**Refer to Exhibit 1, Issue 4**

**31.** Overall, we concluded that Scottish Enterprise's arrangements reflect good practice. We discussed with management one area for enhancement. Staff are required to register interests of their spouses, friends and family. Members are only required to register their own personal interests.  Requiring the registration of the interests of members' spouses, family and friends would align the two policies and apply good practice consistently across the organisation.  Management are of the view that the current differences between Staff Code and the Members' Code are appropriate, due to the different executive and non-executive roles carried out. Board Members' influence, via decisions taken at Board meetings, is adequately covered by the Declaration of Interest process covering these meetings.

## Exhibit 1

Key findings and action plan 2017/18

| Issue identified | Management response | Responsible officer and target date |
|---|---|---|
| **Audit findings – controls testing** | | |
| **1 Reconciliations** | | |
| We identified the following issues in relation to routine accounting reconciliations.<br>• two sub-ledger reconciliations had not been signed and dated by the preparer and reviewer. This is a key control that evidences timely review of the reconciliation and segregation of duties | We accept that the reconciliations were not signed and dated. Due to other commitments preventing the reviewer from not always being physically present, the reconciliations were reviewed online. The normal protocol of signing and dating reconciliations will be re-introduced with immediate effect. | Ailsa Boyle<br>Finance Centre Team Leader<br><br>April 2018 |
| • while cover sheets for a sub-ledger reconciliation were retained on file, there was no supporting evidence from either the ledger or the sub-ledger to confirm the balances on the reconciliation | The supporting evidence from the respective ledgers will be retained on file as part of the documentation for the reconciliation. | |
| • a small reconciling difference on the Investment Capital Control Account has existed for around twenty years. | A small difference has existed since the creation of the previous investment accounting system in 1997 (21 years). | |

| Issue identified | Management response | Responsible officer and target date |
|---|---|---|
| **There is a risk of fraud or error if there is inadequate segregation of duties and/or inadequate management oversight of ledger reconciliations. Reconciling differences may mask a larger offsetting imbalance. If necessary, the amount should be considered for write-off.** | Given the stability of the difference over a long period of years SE believes the risk of compensating errors to be low and will write off the difference at March 2018. | David Burns<br>Head of Financial Accounting<br>April 2018 |
| **2 Payroll validation** | | |
| In 2016/17, we recommended that Scottish Enterprise should introduce a check of the existence of staff on the payroll. This is a key control to mitigate the risk of payments to 'ghost' employees. We acknowledged that there were actions to monitor changes to the payroll but concluded that these did not provide assurance over existence of staff on the payroll.<br>Management agreed to review processes following the introduction of the new HR system.<br>We found that there has been no change to controls in respect of payroll validation.<br>**There is a risk that Scottish Enterprise does not identify 'ghost' employees on the payroll and that payments not due are made.** | The new HR system has not yet been introduced.<br>As an interim measure until the new HR system is implemented, the HR Customer Delivery Team will issue quarterly reports to managers and leaders and ask that they check off their existing employees. The first quarterly reports were issued on 13 April. Any new system will give managers real time access to direct report numbers and information, which will remove any risk of ghost employees. | Nicky McLeod<br>HR Manager<br>April 2018 |
| **Audit findings – wider dimension** | | |
| **3 Property disposals – segregation of responsibilities**<br>Scottish Enterprise appoints external agents to value and market properties for disposal, often by the same firm of agents. No specific assurances are obtained from the agents in relation to the segregation of responsibilities required by the SPFM.<br>**There is a risk to the proper and effective disposal process due to the non compliance with the SPFM.** | Revised guidance will be issued to our project managers confirming that on those occasions when agency and valuation commissions are awarded to a single company this will explicitly be carried out under the Informed Consent process set out in guidance from the RICS from Jan 2018. The consultant will be asked to confirm that there is a proper segregation of responsibilities. | Garry Williamson, May 2018 |
| **4 Conflict of interests – outstanding declarations**<br>There were a small number of declarations outstanding at March 2017, and a small | All declarations have now been submitted. | Fiona Fernie<br>HR Manager |

| Issue identified | Management response | Responsible officer and target date |
|---|---|---|
| number of declarations outstanding which still required management review.<br>Management should ensure that these outstanding conflict declarations and management plans are addressed as a priority.<br>**There is a risk that conflicts of interest are not identified and managed in accordance with Scottish Enterprise's Code of Conduct.** | All declarations requiring management approval have been reviewed and approved as necessary. | April 2018 |

Source: Audit Scotland

**32.** All our outputs and any matters of public interest will be published on our website: www.audit-scotland.gov.uk.

# Scottish Enterprise

## Management Report 2017/18

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