Scottish Enterprise

2017/18 Annual Audit Report

AUDIT SCOTLAND

Prepared for Scottish Enterprise and the Auditor General for Scotland

13 July 2018

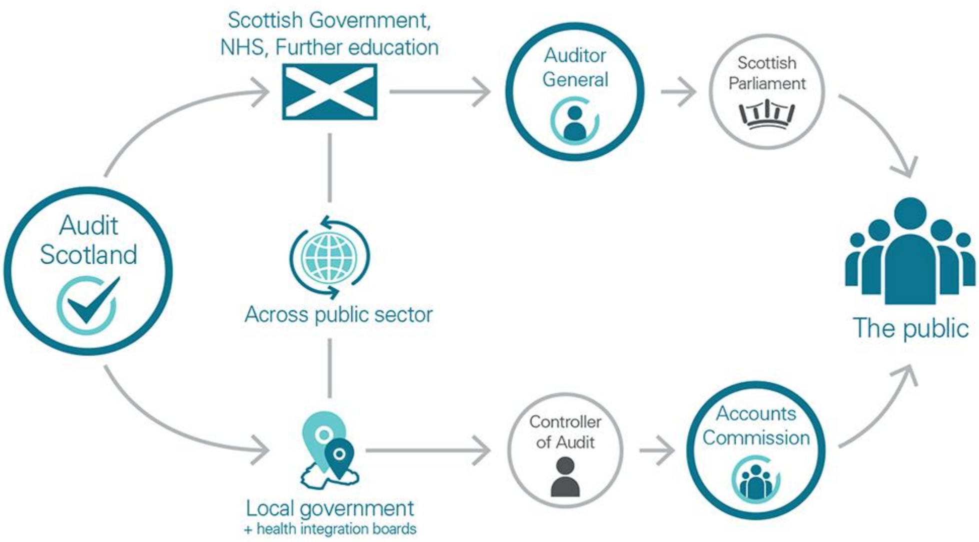
Who we are

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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Key messages

2017/18 annual report and accounts

1 The financial statements of Scottish Enterprise and its group give a true and fair view of the financial position and their net expenditure.

2 The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

3 The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

Financial management

4 Scottish Enterprise has effective financial management arrangements. It remained within its overall resource budget for 2017/18.

5 The overall underspend of £19.7m comprised of £13.2m against the cash budget and £6.5m against the non-cash budget. The cash budget underspend was mainly due to expenditure on Financial Transactions being £11.5m less than anticipated.

6 Systems of internal control operated effectively in 2017/18.

Financial sustainability

7 Scottish Enterprise has financial plans in place for 2018/19 and has deferred longer-term plans until the strategic plan flowing from the Enterprise and Skills review is completed.

8 There are no specific concerns about the overall financial position of Scottish Enterprise.

Governance and transparency

9 Scottish Enterprise has effective governance arrangements that support scrutiny of decisions made by the board.

10 Scottish Enterprise has improved transparency through enhanced disclosures in its annual report. Openness and transparency could also be improved by extending the availability of papers and minutes.

Value for money

11 Scottish Enterprise has a well-developed performance management framework in place.

Introduction

1. This report summarises the findings from our 2017/18 audit of Scottish Enterprise.

2. The scope of our audit was set out in our Annual Audit Plan presented to the December 2017 meeting of the Audit and Risk Committee. This report comprises the findings from:

- an audit of Scottish Enterprise's annual report and accounts
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the *Code of Audit Practice 2016* as illustrated in Exhibit 1.

Exhibit 1
Audit dimensions

Source: *Code of Audit Practice 2016*

3. The main elements of our audit work in 2017/18 have been:

- a review of the main financial systems
- an audit of the 2017/18 annual report and accounts including the issue of an independent auditor's report setting out our opinions
- consideration of the four audit dimensions.

4. Scottish Enterprise has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with the Accounts Direction from the Scottish Ministers. The annual report and accounts includes the following:

- Performance Report
- Accountability Report (which includes the Corporate Governance Report, the Remuneration and Staff Report and the Parliamentary Accountability Report)
- Financial statements and supporting notes.

5. Scottish Enterprise is also responsible for establishing effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

6. Our responsibilities as independent auditor are outlined in the Public Finance and Accountability (Scotland) Act 2000 and the *Code of Audit Practice 2016* and supplementary guidance, and International Standards on Auditing in the UK.

7. As public sector auditors we give independent opinions on the annual report and accounts. We also review and provide conclusions on the effectiveness of the performance management arrangements, suitability and effectiveness of corporate governance arrangements, and financial position and arrangements for securing financial sustainability. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the *Code of Audit Practice 2016* and supplementary guidance.

8. This report raises matters from the audit of the annual report and accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work, and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

9. Our annual audit report contains an agreed action plan at Appendix 1. It sets out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and the steps being taken to implement them.

10. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2017/18 audit fee of £159,460 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

Adding value through the audit

11. Our aim is to add value to Scottish Enterprise by increasing insight into, and offering foresight on, financial sustainability, risk and performance, by identifying areas of improvement and by recommending and encouraging good practice. In so doing, we aim to help the board promote improved standards of governance, better management and decision-making and more effective use of resources.

12. This report is addressed to both the board and the Auditor General for Scotland and will be published on Audit Scotland's website http://www.audit-scotland.gov.uk/ in due course.

13. We would like to thank all management and staff who have been involved in our work for their cooperation and assistance during the audit.

Part 1

Audit of 2017/18 annual report and accounts

Main judgements

The financial statements of Scottish Enterprise and its group give a true and fair view of the financial position and their net expenditure.

The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

Audit opinions on the annual report and accounts

The annual report and accounts are the principal means of accounting for the stewardship of resources and performance in the use of those resources.

14. The annual report and accounts for the year ended 31 March 2018 were approved by the board on 29 June 2018. We reported within our independent auditor's report that in our opinion:

- the financial statements give a true and fair view and were properly prepared
- expenditure and income were regular and in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the accounts direction.

15. Additionally, we have nothing to report in respect of misstatements in information other than the financial statements, the adequacy of accounting records and the information and explanations we received.

Submission of annual report and accounts for audit

16. The timetable for the financial statements audit is challenging for Scottish Enterprise and the audit team. We received:

- the unaudited single entity financial statements on 14 May 2018 in line with our agreed audit timetable
- the complete group annual report and accounts on 28 May 2018, including all narrative (the performance and accountability reports).

17. We had initially discussed with management that we would receive elements of the performance and accountability reports on 14 May 2018, with the remaining narrative on 23 May 2018. The delays to the performance and accountability reports led to increased pressures during the remaining period of the audit. We shall continue to discuss with management how best to address these pressures.

18. The working papers provided with the unaudited financial statements were generally of a high standard.

19. Finance staff provided good support to the audit team which helped ensure the final accounts audit process ran smoothly.

Whole of Government Accounts (WGA)

20. In accordance with the WGA guidance we are required to complete the assurance statement and submit to the National Audit Office (NAO) by 30 September 2018.

Risk of material misstatement

21. Appendix 2 provides a description of those assessed risks of material misstatement that were identified during the planning process. These risks had the greatest effect on the overall audit strategy, the allocation of staff to the audit and directing the efforts of the audit team. Also included within the appendix are wider audit dimension risks, how we addressed these and our conclusions.

Materiality

22. Misstatements are material if they could reasonably be expected to influence the economic decisions of users based on the financial statements. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement. It is affected by our perception of the financial information needs of users of the financial statements.

23. Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit. We assess the materiality of uncorrected misstatements, both individually and collectively.

24. On receipt of the annual report and accounts we reviewed our materiality bases and concluded that they remained appropriate. We updated the materiality amounts as shown in Exhibit 2.

Exhibit 2
Materiality values

Materiality level	Amount
Group materiality	£2.830 million
Scottish Enterprise single entity materiality	£2.710 million
Performance materiality	£1.415 million
Reporting threshold	£85,000

Source: Audit Scotland

How we evaluate misstatements

25. Presentational and monetary adjustments to the accounts identified during the course of the audit were discussed with senior finance officers who agreed to amend the financial statements. There are no unadjusted misstatements.

26. The net effect of adjustments processed was to increase Scottish Enterprise single entity net expenditure by £1.098m and decrease net assets by £2.197m. Adjustments processed to the group accounts resulted in a decrease in net expenditure of £50,000 and a corresponding increase in net assets. These adjustments reflect a number of compensating amounts, some of which are discussed further below.

Significant findings from the audit in accordance with ISA 260

27. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance. These are summarised in Exhibit 3. Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in Appendix 1 has been included.

28. These findings include our views about significant qualitative aspects of Scottish Enterprise's accounting practices including:

- Accounting policies
- Accounting estimates and judgements
- Significant financial statements disclosures
- Timing of transactions and the period in which they are recorded
- The impact on the financial statements of any uncertainties
- The effect of any unusual transactions on the financial statements
- Misstatements in the annual report and accounts
- Disagreement over any accounting treatment or financial statements disclosure

Exhibit 3
Significant findings from the audit of financial statements

Issue	Resolution
1. Trade and other receivables: accrued EU income Scottish Enterprise's accounts include income accruals for EU funded 'small grants'. Following an internal audit review of contract management in 2017/18, Scottish Enterprise reviewed the associated income accrual. As disclosed in Note 14 of the accounts, the standard of evidence required from third parties to support Scottish Enterprise's claims for European funding was not available in many cases. Consequently, the accrued income attributable to expenditure in 2016/17 was reduced from £6.2m to £2.1m. At 31 March 2018, the total value of accrued income relating to these programmes is £4m. Management anticipates that a claim will be submitted for this funding in 2018/19. In 2016/17 management estimated that 75% of eligible expenditure incurred would be recovered.	Internal audit has followed up the matters raised and has concluded that appropriate action is being taken to address the issues it reported. We reviewed the methodology for accruing EU income and concluded that the methodology appeared reasonable. In view of the problems identified and the impact on the accounts we have requested that the Accountable Officer provides assurances that the accruals for EU income are properly stated. Recommendation 1 (refer appendix 1, action plan)

Issue	Resolution
Following the review, this estimate has been reduced to 37%. Scottish Enterprise should ensure that all relevant grant conditions are met including the retention of the required documentation. There remains a risk that some scheme funding may be disallowed.	
2. Trade and other payables: 'large grant' accruals Included within trade and other payables (£115m) are accruals for large grants to third parties (£14m). This accrual is based on management's assessment of the extent to which grant milestones were reached within 2017/18. The evidence to support this assessment varies and may include: • complete and signed grant claim forms • unsigned grant claim forms • email correspondence from grant claimants confirming progress towards the milestones. There is no standard approach to the evidence supporting the accrual and the audit trail was unclear. There was no documented judgement around the rationale for accruing expenditure prior to receipt of the completed grant claim.	We reviewed eight claims totalling 34% of the accrual and obtained confirmation from management as to the reasoning behind the accruals. We also checked subsequent payments and found that 29% of the claims we sampled had been paid or were about to be paid. Our testing led us to conclude that there were no issues as to the substance of the transactions. There is scope to improve procedures, including the audit trail. Recommendation 2 (refer appendix 1, action plan)
3. Remuneration and staff report The remuneration and staff report in the annual report and accounts presented for audit was incomplete and required management review and assessment against the requirements of the Financial Reporting Manual (FReM).	Management assessed the disclosures required with reference to the FReM and underlying guidance. We concluded that management's disclosures meet the requirements of the FReM.
4. Non-current assets: property, plant and equipment Scottish Enterprise disposed of the Innovo Building, Glasgow during 2017/18 but retained ownership of an adjoining plot of land. At the year-end, Scottish Enterprise identified that the adjoining site had not been included in the asset valuation in previous years. This land was included in the accounts initially presented for audit at a value of £3m. It was subsequently reviewed and revalued at £1.865m, resulting in an increase in the value of property, plant and equipment in the accounts. As this adjustment was below our materiality threshold, we agreed that there was no requirement for restatement of the corresponding 2016/17 figures.	Management has adjusted this in the accounts. Management confirmed that an additional control has been put in place to ensure that all property valuation reports are confirmed by the Senior Responsible Officer in Business Infrastructure. Additionally, the valuers have reviewed all revaluation reports at 31 March 2018 to confirm that there are no other instances where land or buildings are omitted from the valuation report. Recommendation 3 (refer appendix 1, action plan)

Source: Audit Scotland

Other findings

29. We have highlighted below a number of other matters identified during our audit.

Consolidation of subsidiaries and associates

30. Scottish Enterprise invests in a range of third party organisations. Its interest and control is reflected in different ways in its accounts, for example:

- there are a number of companies in which Scottish Enterprise has a controlling interest. These are fully consolidated in the accounts as subsidiaries. There are 20 subsidiaries, of which six are dormant. Scottish Enterprise has a long-term plan to reduce the number of subsidiaries. The largest subsidiary is the Glasgow Science Centre Charitable Trust (GSCCT)

- there are other companies in which Scottish Enterprise has significant interest but no control. These are included in the accounts as associates using equity accounting.

31. The inclusion of subsidiaries and associates increased net operating expenditure by £2.1m and net assets by £52.7m. The increase in net assets is largely due to the consolidation of the GSCCT assets.

32. Our review of the consolidation process identified accounting, disclosure and procedural issues. These include:

- GSCCT recognises a contingent liability of £69.5m for potential repayment of the original grant for the construction of the Science Centre in the event of default/change of use. £33.3m of this liability relates to a Scottish Enterprise Group company. This contingent liability has never been included in the group accounts. Management subsequently agreed to disclose this as a remote and unquantified contingent liability in the Accountability Report. We agree with this assessment.

- Scottish Enterprise had incorrectly classified £256,000 of GSCCT rental income as Income from Contributions. Management agreed to adjust the accounts for this error.

- To ensure the completeness of its related party disclosures, Scottish Enterprise issues a list of all group related parties to its subsidiaries. This did not occur in 2017/18. Management has assured us that there are no material related party disclosures that have not been reported.

- Management should review its joint working with other bodies to determine whether there are any joint arrangements that require disclosure in the annual report and accounts and/or to be accounted for on an equity basis.

- There is inconsistency between the accounting policies of the Scottish Enterprise Group and some of its subsidiaries which are addressed through the consolidation process. The most significant issue relates to the valuation of the Glasgow Science Centre. There may also be some intangible assets owned by subsidiaries that are classified as tangible fixed assets. We are content that these intangible assets are not material in the context of our opinions on the accounts.

- The working papers used to prepare the group accounts are complex and difficult to follow. The complexity of the working papers increases the risk of material error or misstatement.

Recommendation 4

Management should undertake a review of its consolidation procedures. This review should include the application of consistent accounting policies; a review of the group boundary and related party procedures. Management should also consider streamlining the group accounts working papers.

(refer appendix 1, action plan)

Financial investments

33. Note 8 of the financial statements refers to investments held at fair value of £324m (£322m disclosed in the group accounts). Note 25 provides further information on these investments. It records that Scottish Enterprise holds investments (loans and shares) in 517 companies at an original cost of £313m (prior to revaluation) and excludes any interests which are consolidated. Scottish Enterprise acts as a passive investor and does not exercise control over these companies. As a consequence, they are not consolidated in the group accounts, but carried as investment assets which reflect Scottish Enterprise's aim to drive economic growth by investing alongside venture capital co-investment partners.

34. During 2017/18, Scottish Enterprise wrote off a number of debts including investment write-offs of £8.4m. The Scottish Government were advised of any write-off in excess of £250,000 in accordance with agreed procedures.

35. The Accountability Report within the financial statements also refers to a write-off approved by the Scottish Government subsequent to the end of the financial year of up to £1.7m as part of a re-negotiation of a lease (this is not included in the write-off made during the year).

Non-current assets

36. Note 5 to the accounts includes assets under construction with a net book value of £1.2m. This relates to the Edinburgh Bioquarter project.

37. £2.4m was spent on the project during 2017/18 and at 31 March the project was close to completion with only the completion certificate outstanding. The asset was revalued downwards to £1.2m as part of the annual revaluation process. While assets under construction are generally held at cost, management have recognised an impairment of £1.2m to bring the carrying value of the asset in line with its fair value as the fair value is considerably less than cost. We agree with this treatment given the proximity of completion of the asset and its transfer into operational use.

38. In our 2016/17 Annual Audit Report, we reported that Scottish Enterprise did not maintain an up to date, detailed asset register for non-property assets and these assets are not individually identifiable. This relates to plant and equipment, furniture and fittings and information technology assets. Management advised that work is underway to create new asset registers to record these assets and is due to be completed by December 2018. While we acknowledge that these assets have a relatively small net book value of £314,000, there is a risk that the absence of a register may mean that the assets may no longer be held by Scottish Enterprise and/or they may not be in the expected location.

Financial transactions

39. The accounts include a £57.4m Scottish Government allocation in respect of financial transactions. This funding has been provided to finance equity investments and the provision of loans. Financial transactions funding is repayable over variable periods and has been recognised as a liability in Scottish Enterprise's accounts. Management has agreed this accounting treatment with the Scottish Government.

Follow up of prior year recommendations

40. We have followed up actions agreed in 2016/17 to assess progress with implementation. We have reported progress of these prior year actions in Appendix 1. They are identified by the prefix b/f (brought forward).

41. Five agreed actions were raised in 2016/17. Of these:

- one has been fully implemented
- three are ongoing and have been updated to reflect the 2017/18 position
- one has been partly actioned and is no longer being taken forward.

42. Overall, Scottish Enterprise has made progress in implementing these actions. For actions not yet implemented, revised responses and timescales have been agreed with management, as set out in Appendix 1.

Part 2
Financial management

Main judgements

Scottish Enterprise has effective financial management arrangements. It has remained within its overall resource budget for 2017/18.

The overall underspend of £19.7m comprised of £13.2m against the cash budget and £6.5m against the non-cash budget. The cash budget underspend was mainly due to expenditure on Financial Transactions being £11.5m less than anticipated of which £10m was ring-fenced.

Systems of internal control operated effectively in 2017/18.

Financial performance in 2017/18

43. 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.

44. Scottish Enterprise reported an outturn of £209m remaining within its overall Departmental Expenditure Limit (DEL) for 2017/18 with an underspend of £19.6 million. The financial performance against DEL is shown below in Exhibit 4.

45. The majority of the underspend is as a result of an £11.5m underspend against the Financial Transactions budget. Financial Transactions income is loan financing received from the Scottish Government which can be used for providing loans or equity financing to the private sector. £10m of this underspend relates to Scottish Enterprise's planned investment in the Scottish European Growth Co-investment Programme (SEGCP). Scottish Enterprise is committed to invest £50m between 2017/18 and 2019/20 on this programme. Due to a lack of deal activity during 2017/18, none of the planned investments (£10m) were made through the SEGCP. The Scottish Government is committed to underwrite the £50m expenditure over the remaining two years of this commitment.

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Exhibit 4
Performance against DEL in 2017/18

Performance	Initial budget £m	Final budget £m	Actual outturn £m	Overspend/ (underspend) £m
Resource DEL	137.950	142.434	141.109	(1.325)
Capital DEL	21.900	30.600	30.281	(0.319)
Financial Transactions	35.000	45.000	33.483	(11.517)

Performance	Initial budget £m	Final budget £m	Actual outturn £m	Overspend/ (underspend) £m
Non-cash	10.600	10.600	4.100	(6.500)
Total DEL	**205.450**	**228.634**	**208.973**	**(19.661)**

Source: June 2017 Grant In Aid Letter; May 2018 Spring Budget Revision Grant in Aid Letter; Scottish Enterprise 2017/18 Annual Report and Accounts

Budgetary processes

46. A number of adjustments were made to the original budget. Total DEL budget increased by £23m (11%) during the year; resource DEL by £4.5m, capital DEL by £8.7m and the financial transactions allocation by £10m.

47. Internal audit reviewed budgetary control processes and noted that that Scottish Enterprise has effective processes and controls in place for budget setting, control and reporting. It found that Scottish Enterprise operates a robust monitoring and reporting system which ensures that any variations, deviations and failure to achieve financial targets are identified and reported to budget holders, senior management and the board.

48. Internal audit also identified that Scottish Enterprise experienced a disproportionate increase in spend in the last quarter of the financial year. This required significant intervention from the Corporate Planning and Performance team to ensure that year-end targets are met. Internal audit concluded that this is an organisation-wide operational issue which requires further attention.

49. From our review of budget monitoring reports, board papers and committee papers, we confirmed that senior management and members receive regular, timely and up-to-date financial information on the financial position.

50. We concluded that Scottish Enterprise has effective budgetary monitoring and control arrangements that allow members and officers to carry out effective scrutiny of its finances.

Review of property disposals

51. As part of our audit, we reviewed Scottish Enterprise's property disposals process to assess how income targets were being managed and assessed the process against guidance.

52. We concluded that Scottish Enterprise had effective arrangements to monitor progress against the 2017/18 disposals target and that Scottish Enterprise's property disposals process largely complied with the Scottish Public Finance Manual (SPFM). We identified some scope for improvement, which management has agreed to address.

Systems of internal control

53. We identify and test the key internal controls in the accounting systems which we regard as significant in producing the financial statements. Our objective is to gain assurance that Scottish Enterprise has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

54. Our findings were included in the management report presented to the Audit and Risk Committee in April 2018. We concluded that the controls tested were operating effectively. We identified two control weaknesses relating to ledger reconciliations and payroll validation (to confirm the existence of employees). We developed further audit procedures to gain assurance in these areas and no significant issues were identified.

ICT review

55. Our ICT audit work this year focussed on cyber resilience (reported at paras 94-96). We also followed-up points raised in last year's ICT overview report. There were four risks raised in the 2016/17 ICT overview report. Progress made against each of the four points can be summarised as follows:

- The project to complete documented procedures within Enterprise Information Systems (EIS) is still in progress.
- A single security policy across the EIS partnership is not yet in place. We note that work has progressed in some areas to unify security practices, such as a standardised approach to the Office 365 project across the partnership.
- EIS has engaged with the partners' business requirements to prepare an Information Technology Strategy (the EIS strategy) and EIS Development Plan.
- EIS management has reported to the partnership board that the relationships have improved, with a noted decrease in severe incidents. The service audit reports a significant decrease in findings in 2018 compared to 2017.

56. As Scottish Enterprise does not control its information technology provision directly, assurance on the managed delivery of technology services (installation management, application development and support and desktop services) are obtained through the commissioning of an ISAE 3402 report (International Standard on Assurance Engagements). Use of the standard allows the reviewer to issue a report for use by user organisations and their auditors on the controls at a service organisation that are likely to impact or be a part of the user organisation's system of internal control over financial reporting.

Part 3
Financial sustainability

Main judgements

Scottish Enterprise has financial plans in place for 2018/19 and has deferred longer-term plans until the strategic plan flowing from the Enterprise and Skills review is completed.

There are no specific concerns about the overall financial position of Scottish Enterprise.

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

2017/18 financial position

57. The Statement of Financial Position summarises what is owned and owed by Scottish Enterprise. This shows taxpayers' equity – an accounting measurement of the amount invested that has continuing public benefit. It shows how much of this has arisen from the application of revenues and that which has resulted through changes over time in the value of assets.

58. The financial statements show that Scottish Enterprise has net assets of £616.3m, an increase of £42.9m. We noted the following significant movements in Scottish Enterprise's assets and liabilities:

- The pension net asset has risen by £51.8m due to the actuarial assumptions used to value the scheme liabilities at March 2018.
- Cash and cash equivalents have risen by £19.1m. £65m of this cash is held for capitalisation of investment funds and income from investment disposals, which has been accumulated over several years. This income is ring-fenced and can only be used on similar investment projects. Scottish Enterprise and the Scottish Government continue to discuss how these funds can be applied within the existing budget arrangements.
- Property, plant and equipment has decreased by £20.3m to £178.4m. This movement reflects in-year disposals as well as the transfer of £20.6m to current assets (assets classified as held for sale).
- Investments have increased by £46.2m to £322.3m largely due to investment additions.
- Other non-current payables have increased by £36.7m. This is largely due to the receipt of £38.3m Financial Transactions loan-financing income which will be repaid in due course to the Scottish Government.

Financial planning

59. A draft budget was presented to the board and subsequently approved in February 2018 as part of the 2018/19 business plan. The agreed budget of £358.3m reflects an increase of £78m (37%) in Scottish Government funding offset by a decrease of £11m in other income. The 2018/19 budget includes:

- a resource allocation of £142.9m which is slightly higher than the initial 2017/18 budget allocation of £138.0m

- capital DEL of £42.9m (an increase of £30m). The increased capital allocation reflects a ring-fenced Research and Development allocation of £15m and the baseline budget was increased to reflect projected pipeline projects

- Financial Transactions funding of £85.5m (an increase of £43m); in addition to the baseline increase of £13m, ring-fenced allocations were provided to fund activity through the SEGCP and the allocation for the Energy Investment Fund (the successor fund to the Renewable Energy Investment Fund (REIF)) was increased by £10m

- £68.8m of other income which is largely from the Scottish Investment Bank (£35.2m) and property disposals (£14m). This has reduced by £11m, when compared to the previous year, mainly due to a decrease in forecast income from property disposals.

60. The 2018/19 expenditure budget reflects this increased level of funding with planned expenditure of £358.5m. The budget has been structured to reflect the new strategic aims of the 2018/19 business plan.

61. The challenge for Scottish Enterprise will be to ensure that the budget is utilised effectively to identify business investment opportunities.

Longer-term financial planning

62. We reviewed the financial planning systems and assessed how effective they are in identifying and addressing risks to financial sustainability in the longer-term.

63. Scottish Enterprise prepared three-year business plans; 2017/18 is the third year of the 2015-2018 business plan. Management have advised that they have deferred development of a longer-term financial strategy given the Scottish Government review of Enterprise and Skills (see paras 71-78 below).

64. We accept that this review has caused uncertainty and agree with the decision to defer longer term financial planning until the position is clearer. Following the agreement of the Strategic Plan by the Strategic Board with all partners, we recommend that a longer-term financial strategy is prepared which considers sensitivity analysis and scenario planning for possible structural and budget changes.

Recommendation 5

We recommend that following the publication of the new Strategic Plan, a longer-term financial strategy (5 years +) supported by clear and detailed financial plans (3 years +) is prepared. This should include scenario planning (best, worst, most likely) with a much clearer assessment of the impact of budget assumptions on activity and any residual risks.

(refer appendix 1, action plan).

EU withdrawal

65. There remains significant uncertainty about the detailed implications of EU withdrawal (i.e. Brexit). It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- Workforce – the extent to which changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour.
- Funding – the extent to which potential changes to funding flows are likely to affect the finances of the organisation and the activity that such funding supports.
- Regulation – the extent to which potential changes to regulation across a broad range of areas overseen at an EU level are likely to affect the activities of the organisation.

66. The impact of Brexit has been incorporated into Scottish Enterprise's business: for example, the risk register includes reference to Brexit across a range of risks and board papers refer to the potential impact of Brexit in the regular economic development updates and funding strategies. Given the level of uncertainty around Brexit at this time, this approach appears reasonable.

Part 4

Governance and transparency

Main judgements

Scottish Enterprise has effective governance arrangements in place that support scrutiny of decisions made by the board.

Scottish Enterprise has improved transparency through enhanced disclosures in its annual report. Openness and transparency could also be improved by extending the availability of papers and minutes.

Governance arrangements

67. Scottish Enterprise is governed by a board that is accountable to Scottish Ministers. At 31 March 2018, the board consisted of the chairman, six non-executive members and the interim chief executive. In 2017/18, there were six board meetings. The board has three sub-committees: Audit & Risk, Nominations & Governance and Remuneration.

68. From October 2017, the remit of the Audit Committee was extended to include responsibility for risk and the committee was renamed the Audit and Risk Committee (ARC). The ARC met three times in 2017/18.

69. We attend all ARCs. Agendas follow a standard format and papers are circulated to members in advance, allowing adequate time for members to review. From attendance at ARCs, we are satisfied that members provide appropriate scrutiny of submitted reports. In particular we considered that the ARC demonstrated good practice in its scrutiny of management in connection with the Internal audit reports on Contract Management.

70. The Chief Executive is also a member of the board. In October 2017 Dr Lena Wilson stepped down from the role of Chief Executive and was replaced on an interim basis by Paul Lewis from October 2017 to May 2018. Stephen Dunlop was appointed as the new permanent Chief Executive and Accountable Officer from 21 May 2018.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.

Enterprise and Skills Review

71. In May 2016, the First Minister announced an end-to-end review of enterprise and skills support. This aims to ensure public agencies are delivering the support Scotland's young people, universities, colleges, training providers, businesses and workers need. The report on the first phase of the review was published in October 2016. It contained ten recommendations focused on ensuring a simpler, more flexible and cost-effective enterprise and skills support system.

72. Phase two of the review commenced in November 2016 with the start of nine projects to take forward the first phase's recommendations. Key actions include:

- creating a Strategic Board to support the co-ordination of agency activities around shared priorities, and help improve performance

- creating a new enterprise agency for the South of Scotland
- developing a more coherent, collaborative and streamlined system of business support.

73. The Strategic Board met for the first time in December 2017 and has now met three times, including a strategy day in January 2018. The Board has an independent Chair and a membership drawn from the Chairs of each of the enterprise and skills agencies as well as non-executive members. The Board's immediate priority has been to develop a Strategic Plan and a measurement and performance framework to underpin the Plan. The Strategic Plan will set out areas of shared focus for the agencies and actions to boost growth and productivity. It is due to be completed later this year.

74. In the interim period, Scottish Enterprise has developed a one-year business plan for 2018/19 which reflects national guidance and the principles of the Enterprise and Skills Review.

75. The Scottish Enterprise board has been kept up to date with developments through regular reporting to board meetings. Board members and senior officers have started working to implement the review's recommendations. This has included exploring potential areas for joint working with the other enterprise and skills agencies. Groups of employees from each of the agencies have met to talk about the implications of the review and identify opportunities to work together. Scottish Enterprise has been involved in the development of the interim Strategic Plan and is taking the lead in several of the actions under the international commitments workstream.

76. The review gives Scottish Enterprise a chance to shape the future of enterprise activity. Realising the review's ambitious aims will be challenging and it will require Scottish Enterprise to work effectively with the other agencies to develop shared priorities designed to make a difference across the enterprise and skills sector. Scottish Enterprise also needs to manage the expectations of the Strategic Board, Ministers and its own board.

77. Scottish Enterprise recognises these challenges and the opportunities offered by the enterprise and skills review. There is evidence of a shared commitment to take forward the review's recommendations. These is consensus that closer working can help the agencies to build on their individual achievements to ensure the enterprise and skills system provides the support users need.

78. We recognise the significance of the enterprise and skills review for Scottish Enterprise. The establishment of the South of Scotland Agency and the Scottish National Investment Bank may change Scottish Enterprise's role and responsibilities. We will continue to monitor progress locally and at a national level.

Transparency

79. Transparency means that the public have access to understandable, relevant and timely information about how the board is taking decisions and how it is using resources such as money, people and assets.

80. Scottish Enterprise continues to improve transparency in its annual report and accounts. For example, further information was provided around performance targets and further clarification was provided in compliance with the Accounts Direction. There may be scope for further improvement by the introduction of trend analysis although we accept that the production of a new business plan with new performance measures will preclude this in the short term.

81. We reported in 2016/17 that board and committee meetings are not open to the public. Board minutes are published on the Scottish Enterprise website, but no other papers or minutes are published. Management are of the view that, due to the confidential and sensitive nature of much of the board's business (e.g. deciding whether to award grants and investments), it would not be appropriate to publish all board and committee papers.

Risk management

82. As part of our planning work we reviewed Scottish Enterprise's risk management arrangements and reviewed the risks identified during the year. The board reviews risk management arrangements annually and considers the risk appetite for different categories of risk. The corporate risk register is presented to each meeting of the ARC and is managed by the Executive Leadership Team. Each business unit has its own risk register, which feeds into the corporate risk register.

83. We concluded that Scottish Enterprise's risk management arrangements are effective and reporting arrangements are appropriate.

Internal audit

84. Scottish Enterprise has an in-house internal audit function, which is supplemented by specialist ICT audit from a firm of accountants. Each year we consider whether we can rely on internal audit work to avoid duplication of effort. When we plan to place reliance on internal audit work we carry out an assessment of the internal audit function to ensure that it is sufficient in terms of documentation standards, reporting procedures, quality, and is performed in accordance with Public Sector Internal Audit Standards (PSIAS).

85. We reviewed Scottish Enterprise's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent we could rely on the work of internal audit. In 2017/18 we were able to place reliance on the work of internal audit on those areas advised in our annual audit plan.

Governance statement

86. HM Treasury's Financial Reporting Manual (the FReM) states that Scottish Enterprise must prepare an annual governance statement within the annual report and accounts. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the governance statement.

87. The SPFM does not prescribe a format for the annual governance statement but sets out minimum requirements for central government bodies. Within Scottish Enterprise all Executive Leadership Team members and major subsidiaries are required to provide the Accountable Officer with certificates of assurance together with completion of a detailed internal control checklist. This process has also been extended to the ICT lead partner.

88. We discussed a small number of amendments to the draft governance statement to better reflect the position throughout the year which management agreed to implement. We concluded that the 2017/18 governance statement complies with the guidance issued by the Scottish Ministers and, based on our knowledge and work performed, presents a comprehensive picture of governance arrangements and matters.

National fraud initiative

89. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.

90. We reported in our 2016/17 Annual Audit Report that internal audit completed its review of the 2016/17 NFI exercise, investigating all high-quality recommended matches. No frauds were identified. The results of the exercise were reported to the June 2017 ARC.

Standards of conduct for prevention and detection of fraud and error

91. We have reviewed the arrangements in place to maintain standards of conduct including the Staff and Members' Codes of Conduct. We also reviewed the counter fraud policy, response plan and whistleblowing policy. We concluded that there are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

92. In March 2018, we reviewed Scottish Enterprise's conflict of interest arrangements for staff and non-executive board members. The annual conflict of interests' process took place in February 2018 and was largely complete by the time of our review. Management was actively pursuing the small number of outstanding claims.

93. We concluded that Scottish Enterprise has well-established processes for recording and monitoring potential conflicts of interests for staff and board members. These arrangements reflect good practice. We reported this in our management report, which we presented to the April 2018 ARC.

Cyber security

94. The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017. This requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate.

95. We concluded that Scottish Enterprise, through its membership of the shared service Enterprise Information Services (EIS) arrangement that is managed by Skills Development Scotland (SDS), is actively reviewing and strengthening its cyber resilience arrangements and is participating in the cyber catalyst group of champions. Although there is currently no firm commitment to attain Cyber Essentials accreditation, EIS has undertaken a gap analysis of relevant information security standards which has been subject to review by SDS's internal audit. This analysis has identified that some remedial work is required in identified areas of non and partial compliance. This will require capacity in EIS to deliver, alongside business as usual commitments.

96. Internal audit followed up their findings on cyber security which was reported in June 2016. They noted that of the 16 original recommendations made all had been fully implemented.

General Data Protection Regulation (GDPR)

97. The new GDPR came into force on 25 May 2018. This replaced the UK Data Protection Act (DPA)1998. As a Regulation, all EU member states must implement it in the same way. GDPR sets out more requirements than the DPA and has introduced new and significantly changed data protection concepts.

98. GDPR introduces a wide range of new rights for individuals in respect of their personal data. These include the right to be forgotten, the right to object to certain processing activities and to decisions taken by automated processes. Failure to comply with new GDPR data handling arrangements could result in Scottish Enterprise incurring significant fines.

99. Internal audit assessed Scottish Enterprise's preparations for GDPR and assessed the actions taken to address the GDPR compliance risks identified by management. They noted that Scottish Enterprise had undertaken a GDPR change programme led by an in-house legal team with support from a working group consisting of representatives from all relevant business unit directorates. A Data Protection and Information Governance Officer has been appointed.

100. Internal audit concluded that management was making good progress to ensure compliance with GDPR and that the risks were being appropriately managed. The report noted strong stakeholder engagement and a formal plan is in place to address the key areas of GDPR.

Exit packages and settlement agreement

101. During 2017/18, two employees left Scottish Enterprise under exit packages following the closure of the Russia office. In addition, a third employee left under a settlement agreement. Further information is provided in the staff report within the annual report and accounts.

Good practice: review of conflict of interests

102. As noted above at paragraphs 92 and 93 we noted well-established processes for recording and monitoring potential conflicts of interests for staff and board members. We consider that these arrangements reflect good practice.

Part 5

Value for money

Main judgements

Scottish Enterprise has a well-developed performance management framework in place.

Performance management

103. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure best value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of best value. Where such requirements are not specified we may, in conjunction with Scottish Enterprise, agree to undertake local work in this area.

Value for money is concerned with using resources effectively and continually improving services.

104. 2017/18 was the final year of Scottish Enterprise's three-year 2015-18 Business Plan. The Plan covered four main themes, which were 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 2017 and reflects the priorities and actions outlined in the Scottish Government's Programme for Government.

105. Each meeting of the board receives an integrated finance and performance report. Performance is reported using a traffic light system covering key indicators. Performance reports contain detailed information for each performance target including trend analysis, specific performance issues and actions being taken to improve performance.

106. There are currently sixteen business plan measures and seventeen milestones. Progress against the targets and milestones is reported to the Scottish Enterprise board and in Scottish Enterprise's annual report and accounts.

107. Performance against each measure and milestone is reported in Scottish Enterprise's 2017/18 annual report and accounts. All sixteen of the business plan measures were achieved in 2017/18, although one did not reach the full three-year target: the target which was missed referred to the number of companies assisted to become new or active exporters. Fifteen of the seventeen milestones were met; the milestones which were not achieved related to supporting Scottish companies through establishing a new programme through a London hub and to double SDI's presence in Europe.

2018/19 Business Plan

108. The recently created Strategic Board for Enterprise and Skills (paras 71-78 above) is due to develop a Strategic Plan, which will include a shared measurement and performance framework for the enterprise and skills organisations and encourage greater collaborative working. Scottish Enterprise has therefore developed a transitional one-year 2018/19 business plan, rather than a longer-term business plan; the intention is to align its business plan with the Strategic Plan from 2019/20 onwards.

109. The 2018/19 Business Plan has been based on emerging themes and priorities of the Strategic Board. In addition, the Plan reflects Scottish Enterprise's commitment to

- the development of a shared measurement and performance framework for organisations involved in supporting economic development
- an emerging regional partnership model to more effectively align delivery across Scotland's regions
- a programme of work to join up support services to make it easier for companies across Scotland to access information, advice and funding in a way that suits them
- a new integrated approach to align and increase the impact of several organisations involved in engaging audiences overseas about Scotland as a place to live, study, visit or do business in
- the development of the new Scottish National Investment Bank.

110. In April 2018, internal audit reviewed Scottish Enterprise's business plan and performance measurement. It assessed the systems and procedures in place for the preparation of the 2018/19 business plan, resource allocation processes and the development of the performance measurement framework. Internal audit concluded that the development of the 2018/19 business plan was well managed, with close involvement from the board and executive leadership team.

111. The 2018/19 Business Plan sets six targets, which has reduced from sixteen in the previous plan. Internal audit highlighted that the target ranges are stretching, particularly in relation to R&D investment.

112. We concluded that Scottish Enterprise has an effective performance management framework in place which supports the achievement of value for money and continuous improvement in the way services are delivered.

National performance audit reports

113. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2017/18 several reports were published which are of direct interest to the Scottish Enterprise. These are outlined in Appendix 3. Those reports which are of particular interest to Scottish Enterprise are provided to the ARC.

Appendix 1

Action plan 2017/18

2017/18 recommendations for improvement

No.	Issue/risk	Recommendation	Agreed management action/timing
1	**Trade and other receivables: accrued EU income** Issues have been identified in the retention of the back-up required to ensure successful EU funding. **Risk** There is a risk that some scheme funding may be disallowed or income accrued in error.	Scottish Enterprise should continue to assess all appropriate back up timeously. Scottish Enterprise should ensure that there are adequate controls in place to avoid this issue being repeated in 2018/19. Exhibit 3, point 1	We will continue to assess and pursue evidence of a standard to support claims for European Funding and to maximise the drawdown of European Funding. We will continue to investigate the eligibility of other grant schemes We have reviewed our methodology relating to the estimation of the EU income accrual and applied this to the 2017/18 accrual. Responsible officer: Douglas Colquhoun, Director of Finance and Performance Actioned.
2	**Trade and other payables: large grant accruals** The large grant accrual was based on management's assessment on the extent of reaching project milestones. The evidence to support this assessment can vary. There was no standard approach to the evidence supporting the accrual and the audit trail was unclear. **Risk** There is a risk that expenditure may be accrued inappropriately.	Scottish Enterprise should review the process and related documentation to demonstrate a clear audit trail. Formal guidance for the Grant Management Team on when to accrue should be issued and standardised documentation should be utilised documenting judgements made by staff in the absence of a completed and signed form. Exhibit 3, point 2	We will review the accruals process with the Grant Management Team and agree a standard process for determining the value and recording the basis of year end accruals. Responsible officer: Douglas Colquhoun, Director of Finance and Performance Agreed date: December 2018.
3.	**Non-current assets: property, plant and equipment**	Revised procedures should be introduced between Scottish Enterprise and the valuer to avoid further omissions, and to ensure that updated title plans	We have committed to introducing an additional level of review from the project SRO

No.	Issue/risk	Recommendation	Agreed management action/timing
	Land valued at £1.865m was excluded from the initial version of the valuation report as at 31 March. **Risk** There is a risk that the land and buildings assets are incorrectly valued in the financial statements.	are provided to the valuer ahead of the revaluation exercise. The valuation timetable should be aligned with the annual accounts process. Exhibit 3, point 4	of the assumptions used by the valuer, including land areas, to prevent an occurrence of an error of this nature. We will engage with the valuer to establish whether the timetable can be better aligned with the annual accounts process given the narrow window between the year end and the normal timetable for draft accounts. Responsible officer: Allan McQuade, Business Infrastructure Director Agreed date: December 2018
4	**Consolidation of subsidiaries and associates** We identified two adjustments that were required between Scottish Enterprise's subsidiaries and the group accounts. Scottish Enterprise has complex working papers for group accounts. **Risk** There is a risk that Scottish Enterprise's subsidiaries have different accounting policies, or that there are misclassifications upon consolidation. The complexity of the working papers increases the risk of misstatement.	Management should review the accounting policies and accounting treatment of its subsidiaries and associates in advance of year-end to ensure consistent accounting policies are implemented. Management should review the working papers for group accounts and seek to streamline these. Paragraph 30-32	We will review the accounting policies of the subsidiaries and associates and ensure inconsistencies are either resolved or dealt with in the consolidation process as appropriate. The Group accounts are prepared from a dedicated SUN database which records in journal format, the individual entity accounts and all consolidation adjustments. The format of the supporting working papers for these adjustments has developed over many years and a review will be made to establish if there are opportunities to streamline the papers without losing the necessary history that is built into the papers. Responsible officer: David Burns, Head of Accounting Services Agreed date: February 2019

No.	Issue/risk	Recommendation	Agreed management action/timing
5.	**Financial planning** A short-term business plan and related budget was prepared for 2018/19. **Risk** The risk of managing the financial position going forwards is increasing. 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.	We recommend that following the outcome of the Enterprise and Skills Review, a long term financial strategy (5 years +) supported by clear and detailed financial plans (3 years +) is prepared. 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. Paragraph 62-64	Scottish Government funding awards have historically been between 1 and 3 years in duration. The nature of our expenditure allows for quick revisions to budgets if required. Management agrees to prepare a 5 year financial strategy once the final outcome of the Enterprise & Skills Review is fully confirmed. The timescale will be subject to the progress on the South of Scotland Agency, the Scottish National Investment Bank and the timeframe covered by the next Scottish Government Spending Review. Responsible officer: Douglas Colquhoun, Director of Finance and Performance Agreed date: March 2019
Follow up of prior year recommendations			
b/f 1	**Property, plant and equipment** A number of material adjustments were made to the financial statements in relation to the accounting for non-current assets. The working papers are particularly complicated and require manual intervention. The complexity of the spreadsheets increases the risk of error. There is a risk that the statement of financial position is misstated.	Officers should review the working papers and consider whether the provision of an integrated asset register might assist the process. Clear instructions should be provided to the valuer to ensure the output provided can be applied efficiently and effectively.	There have been some minor updates to ensure consistency in the names of land and building in the asset register. There remains a high level of manual intervention and the spreadsheets remain complex No further action is planned in the short term. Discussions are continuing with the valuer as referred to at action plan point 3 above **Conclusion: Partly Actioned**
b/f 2	Property, plant and equipment An asset under construction was transferred to operational assets during 2016/17 but was not separately identified within the valuation report. Further discussions with the valuer	Instructions should be provided to the valuer on all anticipated completions in order to ensure a full and complete valuation of all operational assets that	Discussions are continuing with the valuer as referred to action plan point 3 above **Conclusion: Ongoing**

No.	Issue/risk	Recommendation	Agreed management action/timing
	clarified that the transferred property had been included within the land valuation. There is a risk that the statement of financial position is misstated.	supports the accounting requirements.	
b/f 3	**Property, plant and equipment** Assets held for sale were not identified by management until after the draft accounts were presented to audit. Back up working papers were not provided until mid-June. Disposal costs have not been excluded from the assessed value. There is a risk that the statement of financial position is misstated.	A process should be introduced to ensure finance staff are advised in advance of the year end of any assets to be identified as held for sale. Disposal costs should be excluded.	All assets held for sale were included in the first draft accounts received on 14 May 2018. **Conclusion: Actioned**
b/f 4	**EU Funding** £4.2m had to be repaid in respect of 2017-13 European Structural Fund programme. The 2016/17 accounts includes EU funding of £30m in respect of the 2014-20 European Structural Fund Programme. There remains a risk that, in relation to the 2014-20 programme, some scheme funding may be disallowed resulting in subsequent pressures on finances.	Officers should ensure that all EU funding requirements and regulations are adhered to.	Internal audit identified significant weaknesses in its review of Contract Management, which makes small grant payments. Refer to action plan point 1 above **Conclusion: Ongoing**
b/f 5	**Financial planning** Scottish Enterprise currently prepares budgets for its 3-year 2015-18 business plan. This covers the next financial year. A stable short term operational budget is maintained based on managing activity and transaction flow as the year progresses.	We recommend that following the outcome of the Enterprise and Skills Review, a long term financial strategy (5 years +) supported by clear and detailed financial plans (3 years +) is prepared. Plans should set out scenario plans (best, worst, most likely); with a much clearer assessment of the impact of	Refer to action plan point 5 above **Conclusion: Ongoing**

No.	Issue/risk	Recommendation	Agreed management action/timing
	The risk of managing the financial position going forwards is increasing. 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.	budget assumptions on activity and any residual risks.	

Appendix 2

Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating our wider responsibility under the *Code of Audit Practice 2016*.

Audit Risk	Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements		
1 Risk of management override of controls ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.	Detailed testing of journal entries. Review of accounting estimates. Focused testing of year-end payables and receivables. Substantive cut-off testing of income and expenditure to ensure that these have been recognised in the correct financial year. Evaluation of 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.
2 Risk of fraud over income and expenditure Scottish Enterprise receives a significant amount of income (£71m in 2016/17) from third parties (excluding Scottish Government funding). The extent and complexity of this income means that, in accordance with ISA 240, there is an inherent risk of fraud. In public sector audit, there is also a risk of fraud over aspects of expenditure, for public sector bodies which have an overall net expenditure. Scottish Enterprise recorded net expenditure of £198m in 2016/17. The Code of Audit Practice requires auditors to consider the risk of fraud over certain types of public sector expenditure. This includes grants and other claims made	Substantive testing of income and expenditure transactions focusing on the areas of greatest risk. Assessment of Scottish Enterprise's property income, which is managed by a third party. Substantive cut-off testing of income and expenditure to ensure that these have been recognised in the correct financial year. Review of accounting estimates. Review of controls in place over grant expenditure to address the risk of fraud.	With the exception of the matters reported at part 1 of this report in relation to the EU accrued income/contract management, our controls testing did not identify any issues with Scottish Enterprise's revenue recognition procedures or expenditure. We substantively tested a sample of income and expenditure transactions, however no issues were identified. Our review of property income processes did not identify any significant matters arising. We reported our findings on Scottish Enterprise's participation in the NFI at part 4 of this report. No significant matters were noted.

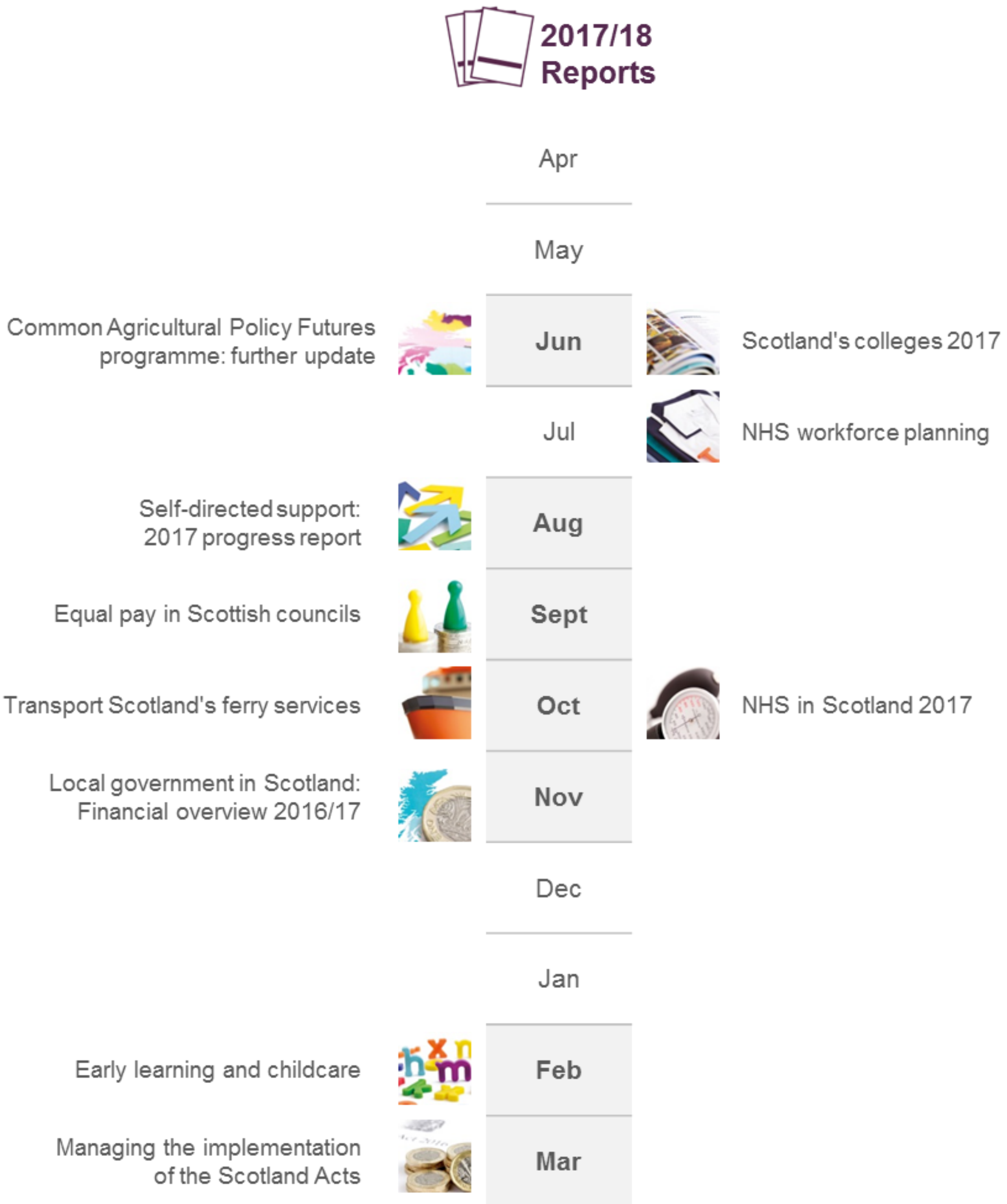
Audit Risk	Assurance procedure	Results and conclusions
by individuals and organisations on the public purse. Scottish Enterprise spends a significant amount of its budget on grants to third parties including Regional Selective Assistance grants, SMART grants and R&D grants.	Focused testing of year-end payables and receivables. Review of Scottish Enterprise's anti-fraud arrangements, including the operation of its conflicts of interests' procedures. Assessment of the results from Scottish Enterprise's participation in the National Fraud Initiative (NFI), which will be considered for Audit Scotland's National Report on NFI.	
3 Accounting estimation and judgements There is a significant degree of subjectivity in the measurement and valuation of the material account areas of land & buildings (£187m), pensions (£40m) and investments, (£276m) which are revalued at year-end. There is an inherent risk that the financial statements are materially misstated due to the degree of subjectivity in the measurement and valuation of these significant areas.	Substantive testing of selected year-end valuation reports. Review of the work of management's expert valuers, including a review of the Scottish Investment Bank's processes for valuing investments.	We reviewed the valuations of land and buildings, 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.
4 Income recognition: EU funding In 2016/17, Scottish Enterprise accrued £30.5m of EU Funding. This related to grant payments and investments made by Scottish Enterprise, for which EU grant funding was to be claimed in 2017/18. In 2017/18, internal audit identified a range of issues as part of the review of Contract Management. There is a risk that 2016/17 accrued EU income may not be recoverable to the extent anticipated. There is a risk that SE may include amounts in its 2017/18 financial statements that exceed the amounts recoverable through EU grant arrangements.	Reliance on internal audit's Contract Management review. Substantive testing to assess EU income.	We reviewed internal audit's work on contract management and substantively tested a sample of EU funded transactions and the related income accrual. Matters arising from this work are reflected in part 1 of this report.

Audit Risk	Assurance procedure	Results and conclusions
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
5 Financial management Scottish Enterprise's budget has high levels of committed expenditure (96% of rebased budget). Achieving a balanced budget depends on achievement of certain income targets, which includes completion of £23m of property disposals. To date, £5.4m of property disposals have been achieved. There is a risk of slippage in income generation, which could impact on Scottish Enterprise's ability to operate within its budget. Any reduction in planned expenditure could affect Scottish Enterprise's ability to fulfil its business plan objectives.	Walkthrough testing of budget monitoring controls. Reliance on internal audit's Budgetary Control Report. Review Scottish Enterprise's property disposals process, including compliance with the SPFM.	No matters noted in relation to budgetary control. The review of property disposal processes identified a small number of procedural matters for management attention. We were able to rely on internal audit's work on budgetary control. Refer to part 2 of this report.
6 Financial Sustainability Scottish Enterprise has an agreed budget for 2017/18, the final year of its 2014-2018 business plan. The SE board are considering whether to prepare a one-year business plan and related budget for 2018/19 or a three-year business plan (2018-2021) with a one-year financial plan which reflects the Scottish Government's annual funding cycle. In our 2016/17 Annual Audit report, we recommended that, following the outcome of the Enterprise and Skills Review, a long term financial strategy (5 years +) supported by clear and detailed financial plans (3 years +) is prepared. Plans should set out scenario plans (best, worst, most likely); with an assessment of the impact of budget assumptions on activity and any residual risks. The risk of managing the financial position going forwards is increasing.	We will review developments in Scottish Enterprise's long-term financial planning.	No longer-term planning has been undertaken pending the finalisation of the new Strategic Board's (established as part of the Enterprise and Skills review) Strategic Plan. Refer to parts 3 and 4 of this report

Audit Risk	Assurance procedure	Results and conclusions
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.		
7 Governance & transparency The Scottish Government's Enterprise & Skills review led to the creation of a Strategic Board to provide strategic direction to the work of the four enterprise agencies, including Scottish Enterprise. A new South of Scotland agency is also to be established. This Review has had a consequence on Scottish Enterprise's ability to develop its 2018-21 Business Plan and the long-term financial plan. There is a risk of lack of clarity about roles, responsibilities and accountabilities as the new arrangements develop and a risk that this impacts on Scottish Enterprise's effectiveness.	Review impact of the changes on Scottish Enterprise, including impact on the operation of the Scottish Enterprise board.	As noted in part 4 of this report, the Enterprise and Skills Review is likely to have a significant impact on the role and responsibilities of Scottish Enterprise.

Appendix 3

Summary of national performance reports 2017/18



Central Government relevant reports

Common Agricultural Policy Futures programme: further update – June 2017

Transport Scotland's ferry services – October 2017

Early learning and childcare – February 2018

Managing the implementation of the Scotland Acts – March 2018

Scottish Enterprise
2017/18 Annual Audit Report

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