Scottish Enterprise

Report on the 2005/06 Audit

Contents

Key Messages

Introduction

In 2005/06 we looked at the key strategic and financial risks being faced by Scottish Enterprise. We audited the financial statements and we also reviewed aspects of performance management and governance. This report sets out our key findings.

Financial Position

The resource budget outturn for 2005/06 was an overspend of £33 million. Additional resources of £30 million were provided by the Scottish Executive, which reduced the final reported outturn to a £3 million overspend. This represents just over 0.66% of the overall resource budget of £454 million. The additional resource plus the remaining overspend of £3 million has been deducted from the organisation's 2006/07 resource allocation.

Reviews have been undertaken by KPMG and Scottish Enterprise's internal auditors into the circumstances that led to the overspend. A consolidated action plan has been agreed to address the issues raised, bring the organisation's finances back into balance, and meet the requirements of the Scottish Executive to stay within the annual resource allocation. As at September 2006 the Network's objective continued to be the achievement of a balanced resource budget with a bias towards a marginal underspend.

Work is underway to develop the organisation's financial planning framework to better manage commitments and the life-cycle of projects over the period of the Operating Plan. Scottish Enterprise needs to ensure that there is long- term improvement in overall financial management arrangements to better support monitoring and financial decision-making.

Financial Statements

We have concluded that the financial statements of Scottish Enterprise give a true and fair view of the state of affairs of Scottish Enterprise and the Scottish Enterprise Network as at 31 March 2006.

We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

We have also reviewed the other issues which we are required to consider as part of our audit opinion, such as the management commentary, the remuneration report and the statement on internal control. We can confirm that there are no further matters that we need to bring to the attention of Scottish Enterprise.

Performance Management

Audit Scotland report

A study was carried out by Audit Scotland, on behalf of the Auditor General, to determine whether the performance management framework for Scottish Enterprise provides a complete and accurate record of strategic and operational achievements.

A report setting out the key findings from the study was published in March 2006. It highlighted that *measuring the impact of an economic development agency is complex and there is no easy way to assess the impact of its investment on overall economic performance. Similar agencies throughout the world also struggle with these issues and Scottish Enterprise's approach appears to be well advanced to encourage continuous improvement.*

The report also highlighted that in developing its performance management arrangements, Scottish Enterprise recognises the importance of evaluating its activities to provide a clearer assessment of its contribution to growing Scotland's economy. Scottish Enterprise has developed an action plan to address the recommendations made in the report and Audit Scotland will continue to monitor progress made against this plan.

Efficient Government

During 2005/06 Audit Scotland completed a management arrangements review of the Executive's Efficient Government Initiative. The findings from this work are currently being analysed and a consolidated report covering the whole of the Scottish public sector will be made available to the Executive in the near future..

As part of its commitment to the Efficient Government Initiative, Scottish Enterprise agreed efficiency savings targets for 2005/06 with the Scottish Executive, to be delivered from the final year of the Business Transformation Programme (BTP) which was completed in April 2006. BTP has been an important development in supporting change in practices and procedures, to ensure the organisation is more efficient, effective and customer focused. A full evaluation of BTP was reported on by KPMG in June 2005, who concluded that it had been was successfully implemented and adopted, and represented good value for money.

Through BTP, Scottish Enterprise has reported achievement of cash releasing efficiency savings of £5 million and time releasing savings of £7million in 2005/06. A further £1 million cash releasing saving was achieved from a line by line expenditure review. This reported total saving of £13 million compares against an efficiency saving targets of £10.3 million agreed with the Scottish Executive.

Plans are under development to achieve further efficiencies as part of the Initiative in 2006/07. Planned efficiencies of £7 million are anticipated to be generated through a number of projects, including a line by line review of costs, and efficiencies from training programmes. It will be challenging for Scottish Enterprise to deliver on savings, with existing financial constraints and organisational strategic change underway.

Governance

The establishment and operation of an efficient and effective internal audit function forms a key element of effective governance and stewardship. We reviewed internal audit and concluded that they continue to comply with Government Internal Audit Standards and we were able to place reliance on their work.

We examined the key financial systems which underpin the organisation's control environment. We concluded that financial systems and procedures operated sufficiently well to enable us to place reliance on them and to mitigate the risks of material misstatement of the accounts, error or fraud.

Looking Forward

This is the final year of our current appointment to the audit of Scottish Enterprise. From 2006/07 KPMG will be the organisation's appointed auditor for a five year period to 2010/11.

Audit Scotland

November 2006

Introduction

1. This report summarises the findings from our 2005/06 audit of Scottish Enterprise. The scope of the audit was set out in our Audit Risk Analysis & Plan, which was presented to the Audit Committee on 22 March 2006. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.

2. We have issued a range of reports this year, and we briefly touch on the key issues we raised in this report. Each report set out our detailed findings and recommendations and Scottish Enterprise's agreed response. Appendix A of this report sets out the key risks highlighted in this report and the action planned by management to address them.

3. This is the final year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of Scottish Enterprise during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk .

Financial Position

4. In this section we summarise key aspects of Scottish Enterprise's reported financial position and performance to 31 March 2006. We also provide an outlook on future financial issues, including our view on potential financial risks.

Auditor General report on accounts

5. The Auditor General for Scotland prepared a section 22 report, in terms of the Public Finance and Accountability (Scotland) Act 2000, on Scottish Enterprise's accounts for 2005/06 to draw Parliament's attention to its financial position. Within this report he highlighted the factors which contributed to in-year overspending, as:

   - a failure to address an historic shortfall in non cash cover within the resource budget;
   - this shortfall was not factored into the resource allocation model, and therefore total resources available for investment during the year were overstated;
   - the complexity of the application of resource accounting and budgeting to the organisation's key activities of economic growth and investment;
   - the absence of a training programme for managers to help them understand the resource accounting consequences of major investment decisions;
   - the introduction of the new resource allocation model without sufficient controls in place to support this;
   - the absence of a system for strategic prioritisation of projects;
   - a lack of clear responsibility and accountability for the model, and
   - a delay by Scottish Enterprise to act on early financial forecasts which projected an overspend.

6. The section 22 report also highlighted the challenges that Scottish Enterprise faces going forward to be able to effectively manage its financial position, and to address the recommendations of the audit reviews that have been carried out on its overspend. The Auditor General expects external audit to monitor action taken by Scottish Enterprise to address these issues and report back to him on progress during 2006/07.

2005/06 outturn

7. Scottish Enterprise is required to work within the resource budget set by the Scottish Executive's Enterprise, Transport & Lifelong Learning Department. However in 2005/06 Scottish Enterprise overspent against both the cash and non cash elements of its resource budget – see exhibit 1 below.

Exhibit 1 – Performance against Resource Budget 2005/06

Resource Allocation (£m)	Budget	Actual Outturn	Difference
Grant in Aid – cash	444	450	(6)
Resource cover – non-cash	10	37	(27)
Total	**454**	**487**	**(33)**

8. Additional resource budget of £30 million, based on early forecasts, was provided by the sponsoring Department to cover the overspend – see exhibit 2 below. This additional resource plus the remaining overspend of £3 million has been deducted from the organisation's 2006/07 resource allocation. In effect, Scottish Enterprise has been provided with resources advanced from 2006/07, to cover the current overspend.

Exhibit 2: 2005/06 Final Resource Budget Outturn

	Resource Outturn	Additional Allocation	Final Adjusted Outturn
Income	**£m**	**£m**	**£m**
Funding			
- Grant in Aid	429		429
- Utilisation of Cash Reserves	15	5	20
Non-cash resource cover	10	25	35
Total Resource Budget	**454**	**+30**	**484**
Expenditure			
Cash expenditure	459		459
Less: Utilisation of Scottish Co-investment Funds	(9)		(9)
Non cash costs	37		37
Total Expenditure	**487**		**487**
Overspend	**-33**	**+30**	**-3**

9. A consolidated action plan has been prepared which is being used to track progress on implementing the recommendations of Internal Audit's and KPMG's investigations into the factors that contributed to the overspend position. These actions are intended to improve financial management and minimise the risk of overspends in future years. Whilst Scottish Enterprise agreed funding arrangements with

the Scottish Executive, for 2005/06, to help with its financial position, there is a risk that resource problems encountered this year will re-occur in future years, if the underlying causes of the overspend are not fully addressed, through the implementation of the consolidated action plan.

Refer Action Plan No.1

2006/07 budget

10. Scottish Ministers have set an initial resource budget for Scottish Enterprise of £471 million for 2006/7. This comprises:

- an initial £416 million cash – grant-in-aid. This includes a reduction to reflect advances made into 2005/06;
- £35 million to cover non-cash costs. This recognises the inadequacy of cover provided previously, and
- permission for the utilisation of £20 million of the Network's accumulated reserves – see exhibit 3 below. Scottish Enterprise held cash reserves of £27 million at the end of 2005/06 that were not already ring-fenced or locked in to specific projects. The extent to which cash reserves accumulated in previous years can be utilised is limited in any given year by the permission included in the overall resource budget.

Exhibit 3 – 2006/07 Current Planned Income

	TOTAL	'CASH'	'NON CASH'
	£m	**£m**	**£m**
Grant in Aid (original)	450	450	0
Adjustment from the SEETLLD	-34	-34	0
Adjusted Grant-in-aid	**416**	**416**	**0**
Non cash resource (original)	35	0	35
Permission to use surplus	20	20	0
Resource Budget	**471**	**436**	**35**
Other Income Sources	83	83	0
Total Operating Plan	**554**	**519**	**35**
Analysed as:			
Grant in Aid	416		
Use of surplus cash	20		
Other sources	83		
'Total Cash'	**519**		
'Non cash' resource	**35**		
Total Operating Plan	**554**		

11. Scottish Enterprise has a ‘reserve list’ of activities it is managing. These activities relate either to legal commitments or activities where there is high reputational risk of not proceeding. Reserve list activities are over and above that planned within the Operating Plan and forecast expenditure, and initially amounted to £4.6 million for legal commitments and £16.7 million for other higher risk activities. Although the current objective of the Network remains the achievement of a balanced resource budget outturn with a bias towards a marginal underspend, there remains a risk of overspending if committed expenditure is not accommodated within available resources.

Refer Action Plan No.2

12. One of the key recommendations in KPMG’s report was that Scottish Enterprise should prepare a balance sheet, at a minimum of quarterly intervals. A function of this would be to support a basis for ongoing estimation of non cash costs. The first interim Network balance sheet was reported to the November Board meeting. Given the complexity of issues relating to the creation of capital assets and the resultant potential impact on non cash costs it is important the basis for forecasting these continues to be developed, and reported earlier in the financial year.

Financial planning & management

13. Earlier in 2006 we identified in our audit plan that to deliver the strategic priority of supporting sustainable economic growth, Scottish Enterprise needs to put in place a financial strategy which funds the longer term objectives of its Operating Plan, within its annual resource budget. The introduction of the new resource allocation model during 2005/06, in advance of restructuring of network arrangements created a risk of overspending.

14. As noted earlier at paragraph 9, there have been a number of internal and external reviews documenting the reasons for the 2005/06 overspend, and an action plan was developed to address recommendations made. We therefore developed the scope and approach to our planned review of financial planning and management to include consideration of the findings arising from the other reviews and also the actions being taken in response.

15. In our report we recommended that Scottish Enterprise should:

- review its arrangements to support the role of the Board in fulfilling its scrutiny role;
- develop its financial planning framework to better manage commitments and the life-cycle of projects over the period of the Operating Plan;
- ensure sufficient training is provided on public sector financing; and
- review its public reporting framework to better link financial information being presented.

16. As highlighted in the other reviews, Scottish Enterprise also needs to ensure that there is long-term improvement in financial management arrangements to better support monitoring and financial decision-making.

Refer Action Plan No.3

Financial Statements

17. In this section we summarise key outcomes from our audit of Scottish Enterprise's financial statements for 2005/06, and comment on the key accounting issues faced.

Our responsibilities

18. We audit the financial statements and give an opinion on:

- whether they give a true and fair view of the financial position of Scottish Enterprise and its expenditure and income for the period in question;
- whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements, and
- the regularity of the expenditure and receipts.

19. We also review the statement on internal control by:

- considering the adequacy of the process put in place by the chief executive as accountable officer to obtain assurances on systems of internal control, and
- assessing whether disclosures in the statement are consistent with our knowledge of Scottish Enterprise.

Overall conclusion

20. We have given an **unqualified** opinion on the financial statements of Scottish Enterprise for 2005/06.

Issues arising from the audit

21. As required by auditing standards we reported to the audit committee in August 2006 the main issues arising from our audit of the financial statements. The key issues reported were:

Preparation and submission of the accounts

22. There were delays in the preparation of the 2005/06 accounts, resulting in them being submitted for audit later than the date agreed in the timetable. A significant contributing factor to these delays was the extent to which a number of accounts procedures are carried out at the year-end. Many of these tasks, including the identification of assets and investments, valuations, review of provisions and consideration of new or revised disclosure requirements, could be substantially addressed on an

ongoing basis during the year. In addition one lead officer undertakes the majority of the detailed work in preparing the accounts and the consolidation of the Network's accounts.

23. These factors contribute to the workload and complexity of the final accounts, and this is reflected in delays and difficulties in achieving the accounts timetable. An early review meeting should be held between the finance team and external audit to improvement to the accounts preparation and audit process for 2006/07. This will support the development of a realistic timetable for the 2006/07 financial statements.

Refer Action Plan No.4

Careers Scotland

24. On 30 March 2006, the Deputy First Minister and Minister for Enterprise and Lifelong Learning announced that Careers Scotland is to de-merge from Scottish Enterprise. In June 2006 a consultation document was issued by the Scottish Executive, asking for comment on the de-merger. The consultation period ended on 10 September. We agreed with Scottish Enterprise that it was appropriate that there were no provisions or contingent liabilities for the de-merger in the 2005/6 accounts, as the consequences for Scottish Enterprise were unknown and unquantifiable at this stage. There will however be financial and organisational implications of the de-merger in future and we highlighted that the organisation should consider these early in 2006/07. Any provisions or write-offs required as a result of the de-merger could impact on non-cash resources for Scottish Enterprise in future.

Refer Action Plan No.5

Glasgow Science Centre

25. £56 million of *other* property assets are included at historic cost in the accounts, the majority of which relates to Glasgow Science Centre (GSC), a subsidiary of Scottish Enterprise Glasgow. The Government financial reporting manual requires that all fixed assets should be carried at current value in the accounts. Therefore, GSC and other similar property should not be carried at historic cost but should be revalued each year.

26. If GSC is revalued, there will be an impact on the income and expenditure account. However the impact of any revaluation on Scottish Enterprise's financial position would be offset by releasing a related deferred capital grant of £37 million. On the basis that the impact of the revaluation on the income and expenditure account would be minimised by the release of deferred income, and given the undertaking from Scottish Enterprise that the asset will be valued and accounted for in accordance with financial reporting requirements in 2006/07, we accepted the disclosure for 2005/06.

Refer Action Plan No.6

Identifying fixed assets

27. In previous years we reported that Scottish Enterprise did not maintain a non-property fixed asset register and that these fixed assets are identified as a year-end exercise rather than as changes occur during the year. This year the initial draft accounts did not incorporate non-property fixed asset movements as the work to identify them had not been completed. Within the final certified accounts, £15,000 of additions were identified for Scottish Enterprise national in contrast to total non-property additions across the network of £3.5 million. We received assurances on the completeness and accuracy of non-property assets within the letter of representation that the Accountable Officer provides. We also recommend that, for 2006/07, an approach to the ongoing identification and recording of non-property assets additions is developed.

Refer Action Plan No. 7

EU funding

28. In January 2005, the European Court of Auditors (ECoA) undertook an audit of EU programme funding for the period 1996-2000, in relation to funding provided by the European Union, to Scottish Enterprise, over that period. The sponsoring Department's European Structural Funds Division has received a draft report on the audit and is preparing a response with help from local enterprise companies. The process of negotiation with the ECoA can be a lengthy process and there is a risk that there could be a clawback of funding. However, officers confirmed that their, and the Scottish Executive's, view is that this risk is low and it is unlikely that any liability will arise. As the risk of financial impact was assessed as low and it was not feasible to reliably estimate the value of any potential impact, a contingent liability was not disclosed in the 2005/06 accounts. Officers agreed to monitor this position to ensure that if any financial liability arises it is quickly identified and provided for within overall financial plans.

Statement on Internal Control

29. The Statement on Internal Control provided by Scottish Enterprise's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control, set out Scottish Enterprise's approach to this, and recognised that issues arising from the introduction of the new resource allocation framework resulted in an overspend against the 2005/06 resource budget. However, the Accountable Officer has stated that he is satisfied that the issues which arose did not constitute a fundamental breakdown of internal controls.

Regularity Assertion

30. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts was incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.

Performance Management

31. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.

32. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

Performance Management in Scottish Enterprise

33. A study was carried out by Audit Scotland, on behalf of the Auditor General, to determine whether the performance management framework for Scottish Enterprise provides a complete and accurate record of strategic and operational achievements.

34. The study, which followed on from earlier work, covered:

- the performance of the Scottish economy and progress towards *A Smart, Successful Scotland*;
- the framework for measuring performance and the information available on Scottish Enterprise's achievements; and,
- how Scottish Enterprise develops, monitors and evaluates its activities and how it manages performance to encourage continuous improvement.

35. A report setting out the key findings from the study was published in March 2006. It highlighted that *measuring the impact of an economic development agency is complex and there is no easy way to assess the impact of its investment on overall economic performance. Similar agencies throughout the world also struggle with these issues and Scottish Enterprise's approach appears to be well advanced to encourage continuous improvement.*

36. Scottish Enterprise is actively considering how it evaluates its activities to provide a clearer assessment of its contribution to growing Scotland's economy. The recommendations in the report will help support improvement in performance management arrangements within Scottish Enterprise.

37. The key recommendations arising from the study were:

- in assessing and reporting on performance, the Network should work with the Scottish Executive to focus on the contribution being made to Smart, Successful Scotland outcome measures;
- Scottish Enterprise should further investigate the potential of econometric models to estimate the combined impact of its activities;
- targets should be informed by external evidence rather than past performance;
- monitoring frameworks for projects should reflect a focus on outcome measures;
- Scottish Enterprise should continue to improve the quality and consistency of evaluation work and ensure that learning effects are disseminated effectively and are used to challenge the rationale for activities;
- evaluation activity should focus on broader, strategic studies that can deliver a wider picture of impact, based on the range of indicators presented in Smart, Successful Scotland, rather than on gross value added alone; and
- Scottish Enterprise should continue working to ensure that the positive changes at management level are cascaded throughout the organisation.

38. Scottish Enterprise has developed an action plan to address the recommendations made in the report and Audit Scotland will continue to monitor progress made against this plan.

Refer Action Plan No.8

Best Value

39. The Scottish Executive issued high level guidance on Best Value in May 2003, followed by more detailed draft secondary guidance in August 2003. This duty can be described as:

- to make arrangements to secure continuous improvement in performance (while maintaining an appropriate balance between quality and cost);
- to have regard to economy, efficiency and effectiveness, and the equal opportunity requirements; and
- to contribute to the achievement of sustainable development.

40. In May 2005, Ministers decided that they would not bring forward legislation which extends best value in the wider public sector. However, Ministers do wish to encourage and embed the principles of best value across the wider public sector, and further guidance was issued in May 2006.

41. During 2005/06 Audit Scotland carried out a baseline review to establish the arrangements in place across the central government and NHS sectors which support best value and continuous improvement, and to identify areas of good practice. The results of these reviews are currently being analysed and will be issued shortly. It should be emphasised that this exercise does not represent a best value audit across the public sector. Audit Scotland is considering what type of audit approach might be suitable for non-statutory best value. The results from this review will inform that thinking.

42. As part of the work carried out with Scottish Enterprise to contribute to this baseline review, we considered the organisation's arrangements for best value. We also agreed an assessment of the stage of development of each best value characteristic to be included in the summary review.

43. Examples of good practice identified during the review include:

- The use of employee and customer surveys to test understanding of the organisation's vision and strategy.
- Implementation of arrangements to meet duties under the Race Relations Act, including the appointment of an equal opportunities manager and team, supported by a network of equal opportunities champions. In addition, research projects have been commissioned on equal opportunities in the support, promotion and delivery of national training programmes by the skills development team, and the accessibility and use of Careers Scotland services by ethnic minority groups.
- Development of a partnership toolkit within Scottish Enterprise Dunbartonshire (SED). This is being used to evaluate all of SED's strategically and operationally important partnerships, and to inform decision making in relation to those partnerships.

44. Since completing the baseline review, Scottish Enterprise has formally established a best value steering group, consisting of senior officers. Each of whom will lead on one of the nine characteristics of best value. This steering group is chaired by the senior director efficiency and investment, who is also a member of the Scottish Executive's external reference group on best value for public bodies. This reference group produced a self assessment toolkit on best value which Scottish Enterprise is using to assess the organisation's current standing on best value. The self assessment exercise, once completed, will inform the steering group's thinking on driving forward best value in Scottish Enterprise.

Efficient Government Initiative

45. The Efficient Government Initiative is a central part of the government's programme of investment, reform and modernisation. The Initiative is aimed at attacking waste, bureaucracy and duplication in Scotland's public sector. A key feature of the Initiative is that it focuses on the public sector as a whole, rather than individual organisations, with the intention of realising efficiencies through joining up. The primary objective is to deliver the same services with less money or to enable frontline services to deliver more or better services with the same money.

46. In February 2005, the Scottish Executive invited Audit Scotland to audit the performance of the Scottish public sector in achieving the efficiency gains set out in the Efficient Government Plan published in November 2004. The Efficient Government Plan set an aspirational target to achieve efficiency savings of £1,500 million over a three year period to 2007-08.

47. The Minister for Finance and Public Sector Reform published the Outturn Efficiency Report in September 2006 which identified that the Executive had made claimed efficiency savings of £441 million against an in-year savings target of £405 million.

48. During 2005/06 Audit Scotland completed a management arrangements review of Efficient Government activities across the public sector. Our aim was to obtain baseline information on arrangements across a range of Efficient Government related topics. We also carried out an assessment of the management of the overall programme by the Delivery Division and a review of claimed savings within Efficiency Statements.

49. The findings from this work are currently being analysed and will be made available to the Executive in the near future. The Auditor General has indicated his intention to issue a report incorporating the key messages from our review under Section 23 of the Public Finance and Accountability Act 2000.

50. Scottish Enterprise agreed efficiency savings targets for 2005/06 with the Scottish Executive, to be delivered from the final year of the Business Transformation Programme (BTP) which was completed in April 2006. BTP has been an important development in supporting change in practices and procedures, to ensure the organisation is more efficient, effective and customer focused. A full evaluation of BTP was reported on by KPMG in June 2005, who concluded that it had been successfully implemented and adopted, and represented good value for money.

51. Through BTP, Scottish Enterprise has reported achievement of cash releasing efficiency savings of £5 million and time releasing savings of £7million in 2005/06. A further £1 million cash releasing saving was achieved from a line by line expenditure review. This reported total saving of £13 million compares against an efficiency saving targets of £10.3 million agreed with the Scottish Executive.

52. Plans are under development to achieve further efficiencies as part of the Initiative in 2006/07. Planned efficiencies of £7 million are anticipated to be generated through a number of approaches, including a line by line review of costs, and efficiencies from training programmes. It will be challenging for Scottish Enterprise to deliver on savings, with existing financial constraints and organisational strategic change underway.

Refer Action Plan No.9

Governance

53. This section sets out our main findings arising from our review of Scottish Enterprise's governance arrangements. This year we reviewed:

- key systems of internal control;
- internal audit; and
- aspects of information and communications technology (ICT).

54. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position (see paragraphs 4-16).

Systems of internal control

55. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In his annual report for 2005/06 the head of internal audit provided his opinion that, based on the internal audit work undertaken during the year, there was reasonable assurance on the adequacy and effectiveness on the systems of internal control.

56. As part of our audit we reviewed the high level controls in a number of Scottish Enterprise's systems that impact on the financial statements. Our overall conclusion was that, with the specific exceptions noted below, key controls were operating effectively. We agreed with Scottish Enterprise that there were two areas that merit disclosure within the Statement on Internal Control in the 2005/06 accounts. —specifically financial management and the overspend against resource budget. A further issue in relation to the maintenance of a fixed asset register for non-property assets was not considered significant enough for specific disclosure in the Statement. We have already made comment on this issue at paragraph 27.

Internal Audit

57. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2005/06 audit we assessed whether we could place reliance on Scottish Enterprise's internal audit function. We concluded that the internal audit service operates in accordance with the Government Internal Audit Manual and therefore placed reliance on a number of internal audit reviews.

Information and Communication Technology

Business Continuity Planning

58. Business continuity planning (BCP) is designed to reduce the organisation's business risk arising from unexpected disruption of critical functions or operations which are necessary for the continued delivery of services. Our 2005/06 Audit Plan highlighted that Scottish Enterprise was currently improving its ICT business continuity arrangements, in response to issues raised in Internal Audit reports. We therefore carried out an overview of the current arrangements to consider progress on and the effectiveness of the new arrangements.

59. Our overall assessment was that Scottish Enterprise has made significant improvements in its business continuity arrangements, and we identified some examples of good practice. We did note however that there were areas where further work is required to ensure an effective business continuity planning process is embedded across the organisation.

Website

60. As part of our 2004/05 audit of Scottish Enterprise, we carried out an overview of the internet website. This highlighted scope for improvement in a number of areas and appropriate recommendations were made. The review covered the arrangements in place for the following aspects of the website:

    - strategy and development;
    - accessibility and content;
    - maintenance.
    - security;
    - performance; and

61. As part of the 2005/06 audit we reviewed progress on these recommendations and confirmed that a number had been implemented, including:

    - editorial standards have been developed and included in the web policy to ensure website users can expect the provision of contact information in a uniform manner;
    - data protection statements have now been included in the website's "privacy statements"; and
    - an editorial board has been set up and meets on a regular basis to review major changes.

62. Progress has been recorded on remaining actions although a number are still to be fully addressed including approval of the web channel strategy.

SUN Migration

63. As part of Scottish Enterprise's phased upgrade to the SUN finance system, which includes the main financial ledger, a project was initiated during May 2005 to upgrade SUN Accounts from versions four to five. In additional a consolidated ledger was to be developed from the thirteen ledgers used by Scottish Enterprise and the local enterprise companies. The upgrade went live in March 2006.

64. We carried out an overview to assess the management and delivery of the upgrade project to provide us with assurances on the adequacy of controls and the integrity of data in the financial system. Our overall conclusion was that Scottish Enterprise had successfully upgraded the SUN finance system, and there were a number of effective processes as part of that upgrade. We did note however a number of areas where project management could be improved for the benefit of future corporate ICT projects.

Looking Forward

65. Scottish Enterprise faces a number of challenges in 2006/07, which include:

- **Strategic Change** - Scottish Enterprise is currently reviewing its approach to delivering on the refreshed Smart, Successful Scotland and its priorities. The Board have indicated that their strategic focus will be on those priority industries which offer competitive advantage to Scotland, as well as growth potential. Linked to this Scottish Enterprise is looking at ways to exploit the opportunities which metropolitan regions generate for the benefit of surrounding areas. Delivering the Operating Plan, the development of key industries and metropolitan region strategy, with the backdrop of financial constraints in 2006/07, will require efficiencies and optimal use of current resources.
- **2006/07 Outturn** – There is a risk that resource problems encountered this year will continue to impact in 2006/07, without the underlying problems being fully addressed. At the start of 2006/07 there was a reserve list of £4.6 million of legally committed activities, over and above available resources, and expenditure planned within the Operating Plan. Although the current objective of the Network remains the achievement of a balanced resource budget outturn with a bias towards a marginal underspend, there remains a risk of overspending if committed expenditure cannot be accommodated within available resources.
- **Performance Management** - Scottish Enterprise needs to improve how it evaluates its activities to provide a clearer assessment of its contribution to growing Scotland's economy. A number of recommendations were made in Audit Scotland's report to help support improvement in performance management arrangements within Scottish Enterprise. It is important that these improvements are taken forward.
- **Financial Strategy** – Scottish Enterprise should ensure that there is long-term improvement in overall financial management arrangements to better support monitoring and financial decision-making. This will support the development of its financial planning framework to better manage commitments and the life-cycle of projects over the period of the Operating Plan.
- **Shared services** – The Scottish Executive has issued a consultation on a National Strategy for Shared Services. Scottish Enterprise, on behalf of the non departmental body chief executives' forum, commissioned a report on current support service arrangements across these organisations. The report makes a number of recommendations which are currently being considered. Taking forward this agenda and encouraging the development of shared services is a significant challenge for the public sector.
- **Procurement** – The Review of Public Procurement in Scotland report by John McClelland issued in March 2006 contained a significant number of findings and recommendations in

respect of procurement in the public sector. Scottish Enterprise is developing its procurement function in response to this.

- **Best Value –** Revised guidance on best value in the wider public sector has now been issued. Scottish Enterprise will need to ensure that it has mechanisms in place that enable it to demonstrate continuous improvement and that the principles of best value are embedded. Audit Scotland will be developing its approach to best value in the wider public sector in due course.
- **Efficient Government -** The achievement of future Efficient Government targets represents a challenge for the organisation and its partner organisations.

Appendix A: Action Plan

Key Issues and Planned Management Action

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
1	There is a risk that resource problems encountered this year will re-occur in future years, if the underlying causes of the overspend are not fully addressed through the implementation of the consolidated action plan.	The actions identified in the consolidated action plan are being followed through to completion. Progress against the actions identified in the plan are reported to the Network's Audit Committee and the Scottish Executive.	Senior Director — Finance Business Support	31 March 2007
2	Reserve list activities are over and above that planned within the Operating Plan. Although the current objective of the Network remains the achievement of a balanced resource budget outturn with a bias towards a marginal underspend, there remains a risk of overspending if committed expenditure is not accommodated within available resources.	The reserve list is being actively managed to ensure that activity is accommodated within available the Operating Plan resource budgets.	Senior Director — Finance Business Support	31 March 2007
3	Scottish Enterprise should ensure that there is long-term improvement in financial management arrangements to better support monitoring and financial decision-making.	This being addressed in response to KPMG and internal audit reviews.	Senior Director — Finance Business Support	31 March 2007
4	There were delays in the preparation of the 2005/06 accounts, resulting in them being submitted for audit later than the date agreed in the timetable.	A detailed, challenging but achievable timetable for the production of accounts will be agreed with our new auditors.	Senior Director — Finance Business Support	31 December 2006

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
5	There will be financial and organisational implications of the de-merger of Careers Scotland in future. Any provisions or write-offs required as a result of the de-merger could impact on non-cash resources for Scottish Enterprise in future.	These financial and organisational implications are recognised and are being managed. The non cash impact of the demerger will depend on its timing. The key areas have been identified and are being fully assessed	Senior Director — Finance Business Support	Subject to timing of and agreement to, demerger
6	£56 million of *other* property assets are included at historic cost in the accounts. The Government financial reporting manual requires that all fixed assets should be carried at current value in the accounts. Other property assets should be revalued each year.	Arrangements in place to ensure valuations are made as appropriate.	Senior Director — Finance Business Support	31 March 2007
7	Scottish Enterprise does not retain a non-property fixed asset register and that these fixed assets are identified as a year-end exercise rather than as changes occur during the year. An approach to the ongoing identification and recording of non-property assets additions is developed.	A register will be introduced.	Senior Director — Finance Business Support	31 January 2007
8	Scottish Enterprise has developed an action plan to address the recommendations made in Audit Scotland's performance management report. Progress on delivering the action plan should be monitored.	An action plan has been agreed and is being actively managed.	Senior Director, Strategy	31 March 2007
9	Plans are under development to achieve further efficiencies as part of the Efficient Government Initiative in 2006/07. It will be challenging for Scottish Enterprise to deliver on savings, with existing financial constraints and organisational strategic change underway.	The plans to achieve savings during 06/07 are in place.	Senior Director, Efficiency and Investment	31 March 2007