

# Scottish Enterprise

2018/19 Annual Audit Report



 AUDIT SCOTLAND

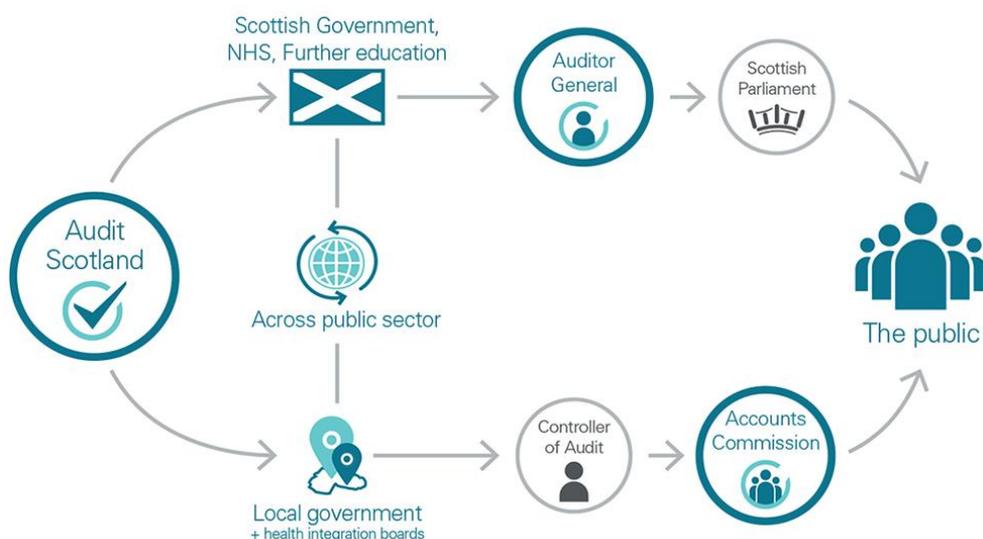
Prepared for Scottish Enterprise and the Auditor General for Scotland

28 June 2019

## 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

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## 2018/19 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, and it remained within its overall resource budget for 2018/19.
- 5 Systems of internal control operated appropriately and effectively in 2018/19, with scope for improvements in some areas.

## Financial sustainability

- 6 Scottish Enterprise has effective financial planning procedures in place and has approved a balanced budget for 2019/20.
- 7 Scottish Enterprise has deferred longer-term financial plans until the creation of the Scottish National Investment Bank (SNIB) and South of Scotland Enterprise (SoSE) in 2020.

## Governance and transparency

- 8 Scottish Enterprise has appropriate and effective governance arrangements that support scrutiny of decisions.
- 9 Over a period of change in key personnel, Scottish Enterprise needs to ensure internal controls continue to operate effectively and that capacity within its finance function is maintained.
- 10 The performance report included in the annual report and accounts meets the requirements, with scope for further development.

## Value for money

- 11 Scottish Enterprise has a well-developed performance management framework.
- 12 A three-year strategic framework and corporate plan is in place from 2019/20.

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# Introduction

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1. This report summarises the findings from our 2018/19 audit of Scottish Enterprise.

2. We outlined the scope of our audit in our [Annual Audit Plan](#), which we presented to the December 2018 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](#).

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## Exhibit 1 Audit dimensions



Source: *Code of Audit Practice 2016*

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3. The main elements of our audit work in 2018/19 have been:

- a review of Scottish Enterprise's main financial systems
- an audit of Scottish Enterprise's 2018/19 annual report and accounts including the issue of an independent auditor's report setting out our opinions
- consideration of the four audit dimensions of public audit.

## Adding value through the audit

4. We add value to Scottish Enterprise through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements that have been accepted by management
- reporting our findings and conclusions in public
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability

5. In doing so, we aim to help Scottish Enterprise promote improved standards of governance, better management and decision-making and more effective use of resources.

## Responsibilities and reporting

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

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

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

8. Our responsibilities as independent auditor are established by 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.

9. As public sector auditors we give independent opinions on the annual report and accounts. Additionally, we conclude on:

- the appropriateness and effectiveness of performance management arrangements
- the suitability and effectiveness of corporate governance arrangements
- the financial position and arrangements for securing financial sustainability.

10. 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.

11. 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.

**12.** 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 any outstanding actions from last year and progress against these.

**13.** 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 2018/19 audit fee of £162,650 as set out in our [Annual Audit Plan](#) remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**14.** This report is addressed to both Scottish Enterprise and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

**15.** We would like to thank all management and staff for their cooperation and assistance during the audit.

# Part 1

## Audit of 2018/19 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.**

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

### Audit opinions on the annual report and accounts

**16.** The annual report and accounts for the year ended 31 March 2019 were approved by the board on 28 June 2019. We reported within the 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 issued by Scottish Ministers
- the audited part of the remuneration and staff report, and the performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

**17.** 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

**18.** 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 13 May 2019 in line with our agreed audit timetable
- the complete group annual report and accounts on 27 May 2019, including all narrative (the performance and accountability reports).

**19.** The performance and accountability reports contain key financial and performance information which require close consideration. We do not receive

these at the start of the audit, which increases the time pressures on Scottish Enterprise and the audit team later in the process. We shall discuss this again with management in planning next year's audit. The working papers provided with the unaudited financial statements were generally of a good standard. We identified some areas for improvement in relation to the working papers for non-current assets and group accounts preparation.

**20.** Finance staff provided good support to the audit team which helped ensure that, overall, the final accounts audit process ran smoothly.

### Risk of material misstatement

**21.** [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual report and accounts and any wider audit dimension risks that were identified during our audit planning process. It also summarises the work we have done to gain assurance over these risks.

**22.** We have no issues to report from our work on the risks of material misstatement highlighted in our [2018/19 Annual Audit Plan](#).

### Materiality

**23.** Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement and involves considering both the amount and nature of the misstatement.

**24.** Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit. With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

**25.** On receipt of the unaudited annual report and accounts we reviewed our materiality bases and concluded that they remained appropriate. We updated our materiality amounts as shown in [Exhibit 2](#).

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## Exhibit 2

### Materiality values

Materiality level	Single entity	Group
Overall materiality	£2.950m	£3.115m
Performance materiality	£1.770m	£1.870m
Reporting threshold	£103,000	£109,000

Source: Audit Scotland, Scottish Enterprise Annual Audit Plan 2018/19

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### Significant findings from the audit in accordance with ISA 260

**26.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices covering accounting policies, accounting estimates and financial statements disclosures.

**27.** The significant findings 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](#) is included.

### Qualitative aspects of the audit

**28.** Qualitative aspects of the audit include our consideration of accounting policies, significant disclosures, or misstatements. Significant findings in relation to qualitative aspects are included in [Exhibit 3](#).

**29.** Our checks on disclosures identified some minor presentational points for amendment. We have recommended that management completes a relevant checklist, such as the National Audit Office's Financial Reporting Manual (FReM) checklist, in preparing next year's accounts to confirm alignment with the requirements. Management has agreed to consider this in advance of the 2019/20 accounts preparation process.

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## Exhibit 3

### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Trade and other receivables: prepayments</b></p> <p>The accounts submitted for audit included £1.02m in respect of prepayments for seven specific grants paid or payable in 2018/19. The grant scheme requires Scottish Enterprise to make payments to recipients before the recipients incur expenditure.</p> <p>We reviewed related documentation and discussed with management the circumstances, the related accounting treatment and the basis on which Scottish Enterprise had decided to treat all the related amounts as prepaid expenditure.</p>	<p>Management reviewed the basis and considered that three amounts paid in 2018/19 with a total value of £450,000 should not be reflected as prepaid expenditure at 31 March 2019. We agreed with management's assessment.</p> <p>We also agreed with management's assessment that in the circumstances the remaining four grants, which were payable at the year-end, should remain in trade creditors and treated as prepaid on the basis that the recipients were unable to spend the grant on the intended purposes until 2019/20.</p> <p>We reviewed the adjustment for the three amounts paid in 2018/19 and are content that management processed it correctly in the accounts.</p>
<p><b>2. Provisions: dilapidations</b></p> <p>Management recognised a £3.8m provision for dilapidations in respect of 13 properties leased by Scottish Enterprise. This is a new provision in advance of the implementation of IFRS 16 - Leases in 2020/21.</p> <p>Our review identified the need to increase the value of the original dilapidations provision by £0.85m in connection with a leased building which Scottish Enterprise shares with another occupant.</p>	<p>We agreed with management's assessment to include a dilapidations provision in the 2018/19 annual accounts, which now includes the amount of £0.85m identified during the audit.</p> <p>We are content with the calculation of the amount provided and included in the accounts.</p>
<p><b>3. Trade and other payables: annual leave accrual</b></p> <p>Scottish Enterprise has accrued the costs of untaken annual leave (£2.72m). This represents the cost of untaken annual leave at year-end, which is carried forward to 2019/20 and should include salary, employer's national insurance and pension contributions.</p> <p>Our audit identified that the initial calculation did not include related pension costs valued at £0.4m.</p>	<p>Management agreed to adjust the financial statements for this misstatement to ensure that the accrual reflects the full costs associated with untaken leave.</p> <p>We reviewed the adjustment and are content that management processed it correctly in the accounts.</p>

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Issue	Resolution
<p><b>4. Trade and other receivables: accrued EU income</b></p> <p>Scottish Enterprise's accounts include £5.29m of accrued income for EU funded grants.</p> <p>In previous years, we have reported that Scottish Enterprise has written down the level of accrued income. This is because the standard of evidence required from third parties to support Scottish Enterprise's claims for European funding was, in many cases, insufficient. There was a further write-down of accrued income in 2018/19.</p> <p>We reviewed the position during our audit and noted that Scottish Enterprise continues to assess the eligibility of expenditure, together with the associated EU income, and has reduced the amount of income accrued as a result.</p>	<p>Internal audit followed-up matters previously raised regarding the evidence required to support grant claims. It concluded that appropriate action is being taken to address the matters reported.</p> <p>We reviewed the methodology for accruing EU income and concluded that the methodology appeared reasonable.</p> <p>We have sought and received the Accountable Officer's assurances on management's assessment of the amount receivable in the ISA 580 representation letter.</p> <p> <a href="#">Recommendation 1</a> (refer appendix 1, action plan) <a href="#">Appendix 1</a></p>
<p><b>5. Financial instruments: IFRS 9</b></p> <p>The Government Financial Reporting Manual (FReM) requires that IFRS 9 - Financial instruments is adopted from 1 April 2018.</p> <p>Scottish Enterprise reviewed its financial assets in line with the new requirements. The main impact was:</p> <ul style="list-style-type: none"> <li>• an initial assessment of an expected credit loss on the financial assets at 1 April 2018 of £3.4m. This is an estimate of future impairment of loans and is charged to net expenditure. At 31 March 2019, the expected credit loss was assessed as £5.0m</li> <li>• the revaluation reserve balance relating to investments (£103m) was transferred from the revaluation reserve to the general reserve. This is because investments are now held at fair value with movements in value charged to net expenditure, rather than to other comprehensive expenditure and the revaluation reserve.</li> </ul>	<p>Minor amendments were discussed with management who agreed to amend the presentation and disclosure, including the wording of Scottish Enterprise's accounting policies.</p> <p>We reviewed management's application of the IFRS 9 requirements and confirmed that these and the minor changes noted have been processed correctly in the accounts.</p>
<p>Source: Audit Scotland</p>	

## How we evaluate misstatements

**30.** Presentational and monetary adjustments to the accounts identified during the audit were discussed with management who agreed to amend the financial statements. There are no unadjusted misstatements.

**31.** There were no material adjustments to the unaudited annual report and accounts arising from our audit.

**32.** The net effect of the adjustments identified during the audit and processed by management was to increase the Scottish Enterprise single entity net expenditure by £4.93m with a corresponding decrease in net assets. Adjustments processed to the group accounts resulted in an increase in net expenditure of £1.71m and a corresponding decrease in net assets. These adjustments reflect compensating amounts, some of which are discussed above.

## Other findings

**33.** We have highlighted below several other of the more significant matters identified during our audit.

**34.** Scottish Enterprise invests in a range of third-party organisations. Further to our audit recommendation in 2017/18, management is currently undertaking a review of its joint working with other bodies to determine whether there are any joint arrangements that should be considered for disclosure in the annual report and accounts and/or accounted for on an equity basis.

**35.** The courts have ruled that UK defined benefit pension schemes must compensate members for differences attributable to guaranteed minimum pensions (GMPs). Scottish Enterprise's actuary's general advice is that a 'trigger event' is yet to occur. Scottish Enterprise has added a contingent liability note to its accounts to explain and disclose this matter. We are content with the disclosures.

**36.** There are seven equity investments totalling £4.51m, where the Scottish Investment Bank has recommended write-off. These had not been written off by 31 March 2019. We also noted that there are trade receivables totalling £0.88m, which also have not been subject to write-off. As all these balances are fully impaired, there is no impact on the Statement of Financial Position. We noted that none of these has yet been formally written-off and disclosed in the parliamentary accountability report. Management have agreed to commence the process for approving the write-off of these balances.

**37.** Scottish Enterprise is renewing various IT systems. These costs have been charged to revenue. IAS 38 - Intangible assets refers to the acquisition, development, maintenance or enhancement of intangible resources and includes the design and implementation of new processes or systems and computer software. IAS 38 notes that an intangible asset shall be recognised if, and only if:

- it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
- the cost of the asset can be measured reliably.

**38.** We discussed the requirements of IAS 38 with management and recommend that Scottish Enterprise reviews the criteria for intangible assets to ensure that such costs are capitalised appropriately in future. Accounting policies should be amended to reflect the agreed practice.



### Recommendation 2

**Management should review and amend the accounting for intangible assets and the related accounting policies.**

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## Follow up of prior year recommendations

**39.** Scottish Enterprise has made some progress in implementing our prior year audit recommendations. For actions not yet implemented, revised responses and timescales have been agreed with management, and are set out in [Appendix 1](#).

**40.** In particular, we are pleased to report that management has improved the governance of the year-end 'large grant' accruals. This included guidance and training for staff and improved processes for providing evidence of the amounts accrued.

# Part 2

## Financial management



### Main judgements

**Scottish Enterprise has effective financial management arrangements, and it remained within its overall resource budget for 2018/19.**

**Systems of internal control operated appropriately and effectively in 2018/19, with scope for improvements in some areas.**

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

### Financial performance in 2018/19

**41.** Scottish Enterprise's overall objective is to utilise available resources to maximise economic development outcomes. Within this, the main financial objective is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers

**42.** Scottish Enterprise has reported an outturn of £241.744m remaining within its overall resource budget for 2018/19 with an underspend of £0.325m. An additional £1.5m of income was generated from investments previously funded by Financial Transactions for which no budget was provided. These funds were repaid to the Scottish Government during the year. The financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#).

**43.** Scottish Enterprise overspent its Annually Managed Expenditure (AME) budget by £11.376m. AME expenditure can be volatile and includes amounts such as provisions and impairments. The excess of AME costs over the allocation is largely due to higher than expected impairments of financial assets and the recognition of a provision for property dilapidations. (Refer [Exhibit 3](#) above). Management have advised that the Scottish Government have confirmed that the excess will be accommodated within the overall Scottish Government AME allocation.

## Exhibit 4

### Performance against DEL in 2018/19

Performance	Initial budget £m	Final budget £m	Outturn £m	Over (under) spend £m
Resource DEL	137.950	143.069	142.990	(0.079)
Capital DEL	41.400	58.508	58.262	(0.246)
Financial Transactions	68.500	42.030	42.030	0
Financial Transactions (income)	0	0	(1.538)	(1.538)
<b>Total DEL</b>	<b>247.850</b>	<b>243.607</b>	<b>241.744</b>	<b>(1.863)</b>

Source: 2018/19 Grant In Aid Letter (July 2018); Spring Budget Review Grant in Aid Letter (March 2019); Scottish Enterprise 2018/19 Annual Report and Accounts

## 2018/19 financial position

**44.** The Group Statement of Financial Position summarises what is owned and owed by Scottish Enterprise and its group. This shows taxpayers' equity – an accounting measurement of the amount of public money 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.

**45.** The financial statements show that Scottish Enterprise's net assets decreased during the year by £77.558m to £538.762m which was largely attributable to:

- an increase of £31.529m in other non-current payables. This is largely as a result of new financial transactions funding (£40.202m) which is repayable to the Scottish Government (see para 47 below).
- a decrease of £29.066m in the net pension asset to £62.872m, which was a result of the actuarial revaluation at year-end.

## Budget processes and monitoring

**46.** We reported on Scottish Enterprise's budget-setting and monitoring arrangements in our Management Report, which was presented to the April 2019 Audit and Risk Committee (ARC). Scottish Enterprise's Finance team prepares monthly Financial Performance Reports for the Executive Leadership Team (ELT) and the Board. These reports include detailed narrative and trend analysis, explaining the key risks to the budget and changes to planned income and expenditure throughout the financial year. We concluded that Scottish Enterprise has effective budgetary processes that allow members and officers to carry out effective scrutiny of its finances.

**47.** Scottish Enterprise's capital budget has increasingly included Financial Transactions (FT) funding. Scottish Enterprise received £40.2m of FT during 2018/19 and has a total £93.1m repayable to the Scottish Government. This type of funding can only be spent on equity investments and loans outwith the public sector. While this lends itself to Scottish Investment Bank (SIB) activities, there is less flexibility in how the funding can be applied as compared with traditional capital funding.

**48.** During summer 2018, in recognition of the challenges in utilising the available FT budget, Scottish Enterprise established a working group to identify additional areas on which the FT budget could be applied. The work of this Group has continued and proposals that will utilise FT funding during 2019/20 and beyond continue to be developed. Scottish Enterprise were unable to commit all this funding in 2018/19 and returned £28m of FT funding to the Scottish Government with an agreement that up to £10m of this funding could be re-allocated if required to complete additional investment deals by 31 March 2019. Scottish Enterprise was able to utilise a further £1.53m of this funding by the end of the financial year.

## Systems of internal control

**49.** As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance Scottish Enterprise has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**50.** Our findings from the review of systems of internal controls were included in our Management Report presented to the Audit and Risk Committee in April 2019. We identified three key control risks relating to segregation of duties and ledger reconciliations. Management agreed to take corrective action. We developed further audit procedures to gain assurance in these areas and no significant issues were identified.

## Internal audit

**51.** Scottish Enterprise has an in-house internal audit department. Specialist IT audit services are provided by an independent third party on behalf of Scottish Enterprise and their partners in Enterprise Information Services (EIS): EIS is the shared IT arrangement with Skills Development Scotland (SDS) and Highlands and Islands Enterprise (HIE).

**52.** 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 use the work of internal audit. In 2018/19, we were able to place reliance on the work of internal audit on those areas identified in our annual audit plan.

## Standards of conduct for prevention and detection of fraud and error

**53.** Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

**54.** 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.

**55.** We concluded that there are established procedures for preventing and detecting any breaches of these standards including any instances of corruption. We are not aware of any specific issues that we need to bring to your attention.

## National Fraud Initiative

**56.** 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

**57.** We reviewed progress on NFI in April 2019 and found that Scottish Enterprise is pro-active in investigating matches and documents effectively all checks undertaken.

**58.** This year's exercise identified 2,214 matches. At the time of our review, Internal Audit were completing their investigations. Management have advised that this work is now complete and that no frauds or irregularities were identified. Internal Audit intends to report the results of NFI activity to the Audit and Risk Committee in August 2019.

### **Dependency on key suppliers**

**59.** The impact of a failure or collapse of a key supplier can be significant to an organisation and can result in either delays or non-completion of major contracts or, disruptions in the continued provision of vital services. This has brought into focus the risk of key supplier failure and the risk of underperformance in suppliers that are experiencing difficult trading conditions.

**60.** Scottish Enterprise has considered the risk of key supplier failure and is of the view that the most significant risk lies with IT. As noted above, Scottish Enterprise has a shared IT service. EIS is managed by Skills Development Scotland (SDS). The SDS external auditor confirmed that SDS maintains close contact with suppliers and discusses emerging issues at planned regular contract management meetings. No significant issues were identified.

# Part 3

## Financial sustainability



### Main judgements

**Scottish Enterprise has effective financial planning procedures in place and has approved a balanced budget for 2019/20.**

**Scottish Enterprise has deferred longer-term financial plans until the creation of the Scottish National Investment Bank (SNIB) and South of Scotland Enterprise (SoSE) in 2020.**

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.

### Financial planning

**61.** The 2019/20 operating plan was published as part of the overall Strategic Framework 2019-2022 document in June 2019. Scottish Government funding of £275.4m augmented with other income of £46.8m provides a budget for the year of £322.2m. This includes:

- **Resource:** Scottish Government funding of £143.1m includes anticipated in year budget transfers. A £4.1m (3%) baseline decrease was applied across the public sector.
- **Capital:** Scottish Government funding has increased by £5.3m to £63.8m, including anticipated in year budget transfers. This is the second of three years in which an additional £15m has been included for R&D grants and £6.3m CDEL has been awarded for the National Manufacturing Institute for Scotland.
- **Financial transactions (FT):** This has increased by £26.5m to £68.5m. This increase is largely due to the reinstatement of the funds returned during 2018/19 (£28.0m). Management is confident that it will utilise the full FT budget in 2019/20.

### Changing landscape for public financial management and medium to long term financial planning

**62.** Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for some social security benefits. This provides the Scottish Parliament with more policy choices but also means that the Scottish budget is subject to greater uncertainty and complexity

**63.** A new Scottish budget process has been introduced, which is based on a year-round continuous cycle of budget setting, scrutiny and evaluation. As part of the new budget process, the Scottish Government published an initial five-year Medium-Term Financial Strategy (MTFS) in May 2018. The five-year outlook for the

Scottish budget, set out in the MTFS, provides useful context for bodies' financial planning.

**64.** There is significant uncertainty around changes in Scottish Enterprise's business that will take place during 2019/20, with the creation of the Scottish National Investment Bank (SNIB) and South of Scotland Enterprise (SoSE). Therefore, the development of a long-term financial plan will not take place until 2020/21. Given the significant changes in Scottish Enterprise's business, we are content with this approach.

## EU Withdrawal

**65.** There remains significant uncertainty surrounding the terms of the UK's withdrawal from the European Union (EU). EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. 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 potential changes to migration are likely to affect the availability of the people and skills needed to deliver services
- Funding – the extent to which potential changes to existing EU funding programmes are likely to affect the finances of public bodies and the activity that such funding supports
- Regulation – the extent to which potential changes to EU regulations are likely to affect the activities of some public bodies.

**66.** We performed a high-level review of Scottish Enterprise's preparedness for EU withdrawal. Our focus was on the three key areas outlined above. We concluded that Scottish Enterprise has taken reasonable action to prepare for the impact of Brexit. This includes a Brexit Steering Response Group; internal contingency planning; an international staff network; review of the impact on procurement; and a website to help Scottish businesses.

# Part 4

## Governance and transparency



### Main judgements

**Scottish Enterprise has appropriate and effective governance arrangements that support scrutiny of decisions.**

**Over a period of change in key personnel, Scottish Enterprise needs to ensure internal controls continue to operate effectively and that capacity within its finance function is maintained.**

**The performance report included in the annual report and accounts meets the requirements, with scope for further development.**

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.

### Governance arrangements

**67.** Scottish Enterprise is governed by a board that is accountable to Scottish Ministers. At 31 March 2019, the board consisted of the acting chair, seven non-executive members and the chief executive. The chief executive is also a member of the board. A new chief executive and accountable officer was appointed from 21 May 2018.

**68.** The board chair stepped down in December 2018 at the end of his term of appointment. The deputy chair, who had been appointed from November 2018, was appointed to the acting chair role. As a consequence of these changes, he stood down as chair of the audit and risk committee (ARC) and a new temporary chair was appointed. Three new board members were appointed during 2018/19.

**69.** In 2018/19, there were six board meetings. The board has three sub-committees: ARC, Nominations & Governance and Remuneration.

**70.** 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.

### Openness and transparency

**71.** There is an increasing focus on how public money is used and what is achieved. In that regard, openness and transparency supports understanding and scrutiny. 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.

**72.** We reported in previous years 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 considers 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 be inappropriate to publish all board and committee papers. In our view, this area should be kept under review to ensure practices are in line with good practice and public expectations.

## Performance report

**73.** In addition to the opinion on the performance report covered in Part 1 of this report, we also consider the qualitative aspects of the performance report included in the annual report and accounts. The purpose of a performance report is to provide information on a body, its main objectives and strategies, and the principal risks that it faces. It is required to provide a fair, balanced and understandable analysis of a body's performance and, is essential in helping stakeholders understand the financial statements. The performance report is therefore an opportunity for the organisation to 'tell its story' and enhance openness and transparency.

**74.** There are a number of characteristics of financial reporting which make for a high-quality performance report. Audit Scotland published a [Good Practice Note](#) on performance reports in February 2019. This was shared with management in advance of the year-end audit.

**75.** We concluded that Scottish Enterprise's performance report met the requirements of the FReM but that improvements could be made to the narrative to provide a more rounded picture of how Scottish Enterprise applied the funding it receives and what has been achieved during the year. We considered that the report could be enhanced using diagrams and tables and by linking better the individual sections.

**76.** Public bodies are required to identify and report performance measures to demonstrate their effectiveness and efficiency in service delivery and the benefits they provide to the public. Scottish Enterprise's performance report provides a range of information covering the activities of the organisation.

**77.** The Finance & Constitution Committee and the Scottish Government established a Budget Process Review Group to carry out a fundamental review of the Scottish Parliament's budget process. The Group recommended that public bodies strengthen their performance planning and reporting to provide a greater focus on the delivery of outcomes.

**78.** Scottish Enterprise will be expected to take an 'Outcomes based approach' to corporate and business planning, and effectively demonstrate their contribution to the delivery of the government's Purpose and National Outcomes, as set out in the National Performance Framework.

**79.** The information provided in the annual report could be enhanced through the assessment of whether the priorities are being delivered and whether the aims are being achieved together with an assessment of the contribution this makes to the Scottish Government's outcomes.



### Recommendation 3

**Scottish Enterprise should review the content and presentation of its performance report to ensure it takes full advantage of the opportunity to communicate how it has applied the funding it receives and what was achieved. Scottish Enterprise should provide an assessment of achievement against the Scottish Government outcomes.**

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## Organisational restructuring

**80.** Scottish Enterprise restructured its Executive Leadership Team (ELT) in December 2018. In recognition of the need to change and reduce costs, in January 2019, a business case for a voluntary severance scheme was submitted and approved by the Scottish Government.

**81.** As a result, 14 employees agreed voluntary severance with Scottish Enterprise at a total cost of £1.2m, as disclosed in the remuneration and staff report. This included members of the ELT, resulting in a reduction of the ELT from seven to five members.

**82.** The outgoing Chief Financial Officer's role will merge with the Chief People Officer and as a result there will be no direct finance representation on the ELT. There will also be changes in the finance team.

**83.** During this period of significant organisational change, it will be important that controls continue to operate effectively and that capacity within the finance function is maintained. The latter, in particular, could affect Scottish Enterprise's financial capacity and its ability to meet the challenging year-end accounts preparation and audit timetable in 2019/20.



### Recommendation 4

**There is a significant amount of organisational change underway which may increase the risk of controls not operating effectively. Management should ensure there is sufficient capacity in finance to support the business and deliver the year-end accounts.**

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## Enterprise and skills

**84.** In May 2016, the First Minister announced a review of the roles, responsibilities and relationships of Scotland's enterprise, development and skills agencies.

**85.** One of the key developments arising from the review was the establishment of the Enterprise and Skills Strategic Board. The Strategic Board's purpose is to maximise the impact of the collective investment in enterprise and skills development, and to create the conditions conducive to delivering inclusive and sustainable growth. It is tasked with improving the overall performance of the economy. Its membership is drawn from the chairs of each of the enterprise and skills agencies, as well as non-executive members from academic and private-sector bodies.

**86.** In June 2018, the Strategic Board published its outline Strategic Plan that set out its initial priorities (referred to as 'missions'). The full Strategic Plan was published in October 2018 and provided further detail on each of the missions:

- Business Creation and Growth – business creation can spur productivity growth
- Business Models and Workplace Innovation – harness the full potential of progressive business models, workplace innovation and Fair Work
- Future Skills Needs – providing the future workforce with the required complex skill-set
- Exporting – significantly improve Scotland's productivity through export growth.

**87.** Each mission aims to maximise the effect of the enterprise and skills system on productivity and inclusive growth, with a focus on 'hard alignment' between the agencies. Teams have been set up to develop the four missions and a Strategic Planning Joint Working Group ensures coherence among them. The Strategic Plan also identified 14 actions for the agencies and 18 recommendations for the Scottish Government which are set out around the four inter-connected missions. The Scottish Government has established an Analytical Unit, to support the Strategic Board in its decision-making and assessment of the agencies' performance.

**88.** Annual Ministerial Letters of Guidance are developed jointly and issued to the enterprise agencies at the same time. The Scottish Government issued an additional Letter of Guidance to the four agencies in January 2019. The letter makes clear that individual agencies are to undertake operational and strategic planning in line with the Strategic Board's Strategic Plan, and collectively pursue its actions. There is an expectation that the individual agencies work collaboratively with the other agencies, with the Scottish Government, and more widely as required to support the Strategic Board's aims.

**89.** There are also signs of increased collaboration among the agencies. From 2019/20, Scottish Enterprise and Skills Development Scotland (SDS) will introduce an in-house internal audit shared service arrangement.

**90.** Phase 2 of the Enterprise and Skills Review confirmed ministers would establish SoSE to address the economic challenges of the area, driving inclusive growth. Following approval by the Scottish Parliament in March 2019, it is expected that SoSE will be effective from 1 April 2020.

**91.** Internal Audit reviewed preparations for SoSE. They concluded that SE is making a positive contribution to the establishment of a SoSE. In particular, a South of Scotland Transition Team has been established within SE and a Transition Programme Manager was appointed to develop appropriate governance arrangements for the Transition Programme. We will review arrangements for the transfer of staff and properties to SoSE during 2019/20.

**92.** An Implementation Plan for the establishment of SNIB was published in February 2018. In accordance with the Plan, the Scottish Government introduced a SNIB Bill to Parliament on 27th February 2019, with a view to SNIB being established as a separate legal entity and fully operational in 2020 (estimated to be around June 2020).

**93.** We published a briefing paper in May 2019 titled [Enterprise and Skills Review: Core areas of audit interest](#). This paper outlines progress since the review was announced and highlights core areas of audit interest. We will continue to monitor progress at Scottish Enterprise and at a national level.

## Risk management

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

## Cyber security

**95.** 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. As noted above, Scottish Enterprise is a partner in the EIS shared IT service. Last year we

reported that Scottish Enterprise intended to attain cyber essentials accreditation in October 2018. This timescale was extended during 2018/19 and Scottish Enterprise has yet to achieve this accreditation.

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#### **Recommendation 5**

**Scottish Enterprise should continue to work with its EIS partners to ensure cyber essentials is achieved. This will be further developed as the partnership moves towards cyber catalyst recognition.**

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# Part 5

## Value for money



### Main judgements

**Scottish Enterprise has a well-developed performance management framework.**

**A three-year strategic framework and corporate plan is in place from 2019/20.**

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

### Best value

**96.** *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value.

**97.** Compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement. Achieving and demonstrating continuous improvement in performance and outcomes is a core requirement for all public bodies.

**98.** The Chief Executive of Scottish Enterprise is the designated Accountable Officer. A range of processes are in place to help the Accountable Officer demonstrate best value. The annual report and accounts outline how the best value attributes and practices are embedded through its assurance and self-assessment processes. These include:

- Sound and developing corporate governance arrangements to reflect the changing roles and structures within the organisation
- The development of a three-year strategic plan together with an annual business plan
- Budgets and resources are regular monitored
- A systematic risk management approach
- Arrangements are in place to monitor the achievement of outcomes.

### Performance management

**99.** Scottish Enterprise's performance is monitored by the Board, which 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. We review papers to gain an insight into how well performance is scrutinised.

**100.** Internal Audit reviewed the arrangements for reporting non-financial performance. They concluded that overall the figures reported can be adequately

substantiated. However, they identified some issues with the evidence provided to support the performance information in the month-end reports and recommended the need to strengthen the validation processes in certain cases.

**101.** 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.

## 2019-22 strategic framework

**102.** In June 2019, SE published a new strategic framework. This is set within the context of Scotland's overall economic agenda as outlined by the Scottish Government and the Enterprise and Skills Strategic Board. It refers extensively to the National Performance Framework.

**103.** Scottish Enterprise's framework includes a three-year corporate strategy and one-year operating plan. The corporate plan has four ambitions, and the operating plan outlines the five key objectives that support the corporate strategy.

**104.** The framework notes that Scottish Enterprise previously focused on a narrow range of sectors. The new vision is to help create an economically vibrant Scotland. Scottish Enterprise's role is to create more, better jobs that nurture shared wealth and collective wellbeing. The framework notes that Scottish Enterprise will need to transform by creating more jobs and developing the use of digital and data.

## Equalities

**105.** As reported in our April 2019 Management Report, we reviewed Scottish Enterprise's equality policies and procedures as part of our consideration of whether the organisation is using resources effectively and continually improving services. There is a range of policies and procedures in place to promote equalities to its staff, grant recipients and stakeholders.

**106.** We concluded that Scottish Enterprise shows a strong commitment to promoting and complying with equality legislation and is engaging with other organisations to ensure that best practice is shared across the public sector.

## National performance audit reports

**107.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2018/19 several reports were published which are of direct interest to 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 2018/19



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>EU Income</b></p> <p>There have been further write-downs of the level of accrued EU income due to the inadequacy of evidence required to support Scottish Enterprise's claims for European funding. Management continue to review the eligibility of expenditure and the related EU income accrual.</p> <p><b>Risk:</b> There remains a risk that the level of accrued EU expenditure is overstated. There also remains a risk that Scottish Enterprise's ability to use available EU funding will be adversely impacted.</p>	<p>Scottish Enterprise should ensure that all relevant grant conditions are met including the retention of the required documentation.</p>	<p>Scottish Enterprise has implemented procedures to ensure that relevant grant conditions are met and that required documentation is retained.</p> <p>Douglas Colquhoun</p> <p>Completed</p>
2.	<p><b>Intangible Assets</b></p> <p>Scottish Enterprise upgraded and renewed IT systems during the year. These costs have been charged to revenue rather than being capitalised.</p> <p>These could potentially have been capitalised as intangible assets under IAS 38.</p> <p><b>Risk:</b> There is a risk that revenue and capital expenditure is inaccurately reported.</p>	<p>Management should review and amend the accounting for intangible assets and their related policies.</p>	<p>Scottish Enterprise will conduct a review of their accounting policy for intangible assets.</p> <p>Douglas Colquhoun</p> <p>March 2020</p>
3	<p><b>Governance and Transparency: Performance Report</b></p> <p>The performance report could enhance openness and transparency by providing a more rounded and accessible narrative around performance.</p>	<p>Scottish Enterprise should review the content and presentation of its performance report to ensure that the information provided is understandable, accessible and transparent and provides the relevant information. The report should provide clear links and explanation of</p>	<p>Scottish Enterprise will review the way in which the Performance Report is produced and take the opportunity to reconsider the content and preparation.</p> <p>Douglas Colquhoun</p> <p>December 2019</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>Clear linkages should be provided to the National Performance Framework.</p> <p><b>Risk:</b> There is a risk that the Performance Report does not maximise its potential as a means of communicating performance.</p>	<p>performance against national outcomes.</p>	
4	<p><b>Governance and Transparency: Restructuring</b></p> <p>There is a significant amount of organisational change underway within the organisation.</p> <p><b>Risk:</b> There is a risk that controls may not operate effectively during this period of change.</p> <p>There is a risk that the restructuring adversely affects Scottish Enterprise's financial capacity and its ability to meet the challenging year-end accounts preparation and audit timetable</p>	<p>The operation of internal controls and the overall control framework should be emphasised to all staff.</p> <p>Management should ensure there is sufficient capacity in the Finance department to avoid any impact on key finance processes.</p>	<p>Staff continue to be reminded about the importance of maintaining vigilance around the application of the internal control framework across the organisation.</p> <p>Management have plans to ensure that suitably qualified staff are in post to address any perceived risks to key finance processes.</p> <p>Douglas Colquhoun September 2019</p>
5	<p><b>Cyber Security</b></p> <p>Cyber essentials has not yet been achieved.</p> <p><b>Risk:</b> There is a risk that key systems are not resilient enough to evade a cyber-attack.</p>	<p>Scottish Enterprise should continue to work with its EIS partners to ensure cyber essentials is achieved.</p>	<p>Scottish Enterprise will continue to pursue Cyber Essentials alongside the EIS partners.</p> <p>Charlie Smith/Glenn Exton December 2019</p>

### Follow up of prior year recommendations

1	<p><b>Trade and other receivables: accrued EU income</b></p> <p>Issues have been identified in the retention of the back-up required to ensure successful EU funding.</p> <p><b>Risk:</b> There is a risk that some scheme funding may be disallowed, or income accrued in error.</p>	<p>Scottish Enterprise should continue to assess all appropriate back up timeously.</p> <p>Scottish Enterprise should ensure that there are adequate controls in place to avoid this issue being repeated in 2018/19.</p>	<p>This matter has been carried forward to the 2018/19 action plan (point 1)</p> <p><b>Ongoing</b></p>
2	<p><b>Trade and other payables: large grant accruals</b></p> <p>The large grant accrual was based on management's</p>	<p>Scottish Enterprise should review the process and related documentation to demonstrate a clear audit trail.</p>	<p>Management has introduced a new process that provides detail of the required evidence for grants.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>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.</p> <p><b>Risk:</b> There is a risk that expenditure may be accrued inappropriately.</p>	<p>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.</p>	<b>Closed</b>
3	<p><b>Non-current assets: property, plant and equipment</b></p> <p>Land valued at £1.865m was excluded from the initial version of the valuation report as at 31 March.</p> <p><b>Risk:</b> There is a risk that the land and buildings assets are incorrectly valued in the financial statements.</p>	<p>Revised procedures should be introduced between Scottish Enterprise and the valuer to avoid further omissions, and to ensure that updated title plans are provided to the valuer ahead of the revaluation exercise. The valuation timetable should be aligned with the annual accounts process.</p>	<p>A new process has been introduced. All revaluation reports are now reviewed to ensure there are no other instances where land or buildings are omitted from the valuation report.</p> <p><b>Closed</b></p>
4	<p><b>Consolidation of subsidiaries and associates</b></p> <p>We identified two adjustments that were required between Scottish Enterprise's subsidiaries and the group accounts.</p> <p>Scottish Enterprise has complex working papers for group accounts.</p> <p><b>Risk:</b> 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.</p>	<p>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.</p> <p>Management should review the working papers for group accounts and seek to streamline these.</p>	<p>Management noted that there were no material accounting policy changes. No further errors were identified in our audit.</p> <p>Management reviewed the group working papers and concluded they should remain in the same format as previous years.</p> <p><b>Ongoing</b></p> <p><b>2018/19 update:</b> Management have agreed that a further review will be carried out in 2019/20 to establish what can be done to refresh the process.</p> <p>Douglas Colquhoun</p> <p>December 2019</p>
5	<p><b>Financial planning</b></p> <p>A short-term business plan and related budget was prepared for 2018/19.</p> <p><b>Risk:</b> The risk of managing the financial position going forwards is increasing. The ability to manage budget</p>	<p>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.</p>	<p>This has not yet taken place due to the introduction of SNIB and SoSE in 2020.</p> <p><b>Ongoing</b></p> <p><b>2018/19 update:</b> To be determined once there is further clarity on the</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>outturn through controlling uncommitted activity is reducing as elements such as staff costs represent a larger proportion of total spend.</p>	<p>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.</p>	<p>timing/scope of SNIB and SoSE. Douglas Colquhoun</p>

# 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
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Management override of controls (example)</b></p> <p>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 to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Substantive cut-off testing of income and expenditure to ensure that these have been recognised in the correct financial year.</p> <p>Evaluate significant transactions that are outside the normal course of business.</p>	<p>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.</p> <p>Our testing of accruals and prepayments identified some matters which are outlined at exhibit 3 in this report.</p> <p>There were no significant transactions outside the normal course of business.</p>
<p><b>2 Risk of fraud over income</b></p> <p>Scottish Enterprise receives a significant amount of income from sources other than Scottish Government grant (£64m per rebased 2018/19 budget). The extent and nature of this income means that, in accordance with ISA 240, there is an inherent risk of fraud.</p>	<p>Review Scottish Enterprise's anti-fraud arrangements.</p> <p>Walk-through of controls over receivables.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p> <p>Substantive cut-off testing of income to ensure that it has been recognised in the correct financial year.</p>	<p>No issues identified with anti-fraud arrangements.</p> <p>We identified some matters in relation to reconciliations and reported these in our management report. We followed up as part of our year end audit and established that the matters had been addressed.</p> <p>No significant issues identified from revenue transactions or cut-off testing of income.</p>
<p><b>3 Risk of fraud over expenditure</b></p> <p>Most public-sector bodies are net expenditure bodies and therefore the risk of fraud is more likely to occur in expenditure. Scottish Enterprise recorded gross expenditure of £283m in 2017/18.</p> <p>Scottish Enterprise makes a material level of grant payments to third parties such as</p>	<p>Walk-through of controls over payables, including grant expenditure.</p> <p>Substantive testing of grant expenditure.</p> <p>Substantive cut-off testing of expenditure to ensure that it has been recognised in the correct financial year.</p> <p>Assessment of Scottish Enterprise's progress towards</p>	<p>No significant issues were identified from our audit testing.</p> <p>NFI was ongoing at the time of the audit review. Management advise this is now completed with no issues identified (refer to part 2 of this report).</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>Regional Selective Assistance grants, SMART grants and R&amp;D grants as well as a number of small grant payments. Due to the nature of this expenditure there is an inherent risk of fraud over expenditure.</p>	<p>completing the NFI results. This will be considered for Audit Scotland's national report on NFI in due course.</p>	
<p><b>4 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of investments (£323m), land &amp; buildings (£117m) and pensions (£92m). Valuation of investments may also be affected by the requirements of IFRS 9 Financial Instruments, which will be introduced in 2018/19.</p> <p>In 2017/18 we identified scope for improvement in the procedures and in the audit trail for large grant accruals (£14m accrual), an area which is subject to management judgement and estimation.</p> <p>The EU accrued income estimate was revised in 2017/18 following a review by management of the assumptions used.</p> <p>The subjectivity in these areas represents an increased risk of misstatement in the financial statements.</p>	<p>Substantive testing of selected year-end valuation reports.</p> <p>Review of the work of management's expert valuers, including a review of the Scottish Investment Bank's processes for valuing investments.</p> <p>Review of management's assessment of the appropriateness of the assumptions used in the valuation of certain assets and liabilities.</p> <p>We will liaise with management to determine the impact of IFRS 9 and test as appropriate.</p> <p>Substantive testing of year-end grant accruals.</p> <p>We shall review the accrued EU income level given the revision in last year's accounts.</p>	<p>No issues identified with the year-end valuation reports or our review of management's expert valuers.</p> <p>We reviewed the changes introduced as a result of IFRS 9 (refer to exhibit 3 above).</p> <p>No significant issues were identified from substantive testing of grant accruals. Management has improved this process in 2018/19.</p> <p>There has been a further downward revision in accrued EU income (refer to part 1 of this report).</p>

### Risks identified from the auditor's wider responsibility under the Code of Audit Practice

<p><b>5 Financial management</b></p> <p>Scottish Enterprise's rebased budget (October 2018) records that 46% (£147.5m) of expenditure will take place in the final quarter, with 27% (£87.2m) to take place in March 2019.</p> <p>Whilst anticipating a break-even position against its revenue and capital grant in aid budgets, Scottish Enterprise is forecasting a significant underspend in its financial transactions budget.</p> <p>Scottish Enterprise may also find it difficult to meet its target</p>	<p>Review management action for the monitoring and phasing of expenditure.</p> <p>Analysis of expenditure profile compared with prior years.</p> <p>Substantive cut-off testing of expenditure.</p> <p>Review management action taken to make full use of the allocated grant in aid budget.</p> <p>Assess the level of EU-funded expenditure.</p> <p>Review internal audit report on financial transactions.</p>	<p>As reported in our Management Report, overall, Scottish Enterprise has strong budgetary controls and processes. Management returned £28m of FT money to the Scottish Government as it was unable to spend this.</p>
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Audit Risk	Assurance procedure	Results and conclusions
<p>of committing expenditure funded by EU income.</p> <p>There is a risk that:</p> <ul style="list-style-type: none"> <li>management's forecast of final quarter expenditure is not achieved leading to significant underspends</li> <li>Scottish Enterprise will not make full use of its grant in aid allocation (including financial transactions) or EU funding</li> <li>the effectiveness of key controls is compromised due to pressures to achieve budget</li> <li>expenditure may be recognised in the wrong financial year.</li> </ul>		
<p><b>6 Enterprise and Skills Review</b></p> <p>In October 2018, the enterprise and skills strategic board published its first strategic plan. The plan should clarify the strategic direction of Scottish Enterprise and the enterprise and skills agencies. It aims to increase productivity and drive inclusive and sustainable economic growth in Scotland. Actions set out in the strategic plan require Scottish Enterprise to increase collaboration and alignment with the other enterprise and skills bodies.</p> <p>The creation of a new South of Scotland agency and the Scottish National Investment Bank will directly impact on Scottish Enterprise operations.</p> <p>There is a risk that this transition phase has an adverse short-term impact on Scottish Enterprise's business and performance.</p>	<p>Review how Scottish Enterprise is responding to the strategic plan and what impact the new arrangements are having on its:</p> <ul style="list-style-type: none"> <li><b>governance:</b> clarity around new roles, responsibilities and accountabilities</li> <li><b>strategic direction and operations:</b> capacity to deliver on the existing and new duties and its income and expenditure</li> <li><b>performance management:</b> whether appropriate measures are in place to determine and report on the impact of the new arrangements.</li> </ul> <p>Review internal audit reports on the transition to Scottish Investment Bank and South of Scotland agency.</p>	<p>Internal audit identified that Scottish Enterprise is making good progress on the transition to SNIB and SoSE.</p> <p>We published a briefing paper in May 2019 titled '<a href="#">Enterprise and Skills Review: Core areas of audit interest</a>'. This paper outlines progress since the review was announced and highlights core areas of audit interest. We will continue to monitor progress locally and at a national level.</p>

# Appendix 3

## Summary of national performance reports 2018/19

		 <b>2018/19 Reports</b>	
Local government in Scotland: Challenges and performance 2018		<b>Apr</b>	
Councils' use of arm's-length organisations		<b>May</b>	 Scottish Fire and Rescue Service: an update
Scotland's colleges 2018		<b>Jun</b>	
		<b>Jul</b>	 The National Fraud Initiative in Scotland 2016/17
Forth Replacement Crossing		<b>Aug</b>	 Major project and procurement lessons
Children and young people's mental health		<b>Sept</b>	 Superfast broadband for Scotland: further progress update
NHS in Scotland 2018		<b>Oct</b>	
Health and social care integration: update on progress		<b>Nov</b>	 Local government in Scotland: Financial overview 2017/18
		Dec	
		Jan	
		Feb	
		<b>Mar</b>	 Local government in Scotland: Challenges and performance 2019

### Central Government relevant reports

[Scottish Fire and Rescue Service: an update](#) – May 2018

[Scotland's colleges 2018](#) – June 2018

[The National Fraud Initiative in Scotland 2016/17](#) – July 2018

[Forth Replacement Crossing](#) – August 2018

[Major project and procurement lessons](#) – August 2018

[Superfast broadband for Scotland: further progress update](#) – September 2018

# Scottish Enterprise

## 2018/19 Annual Audit Report

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
T: 0131 625 1500 E: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)