Scottish Enterprise

Special audit examination

Prepared for the Auditor General for Scotland

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AUDIT SCOTLAND

Auditor General for Scotland

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Summary

1. Scottish Enterprise (SEn) is responsible for furthering the development of Scotland's economy, enhancing skills relevant to employment, promoting industrial efficiency and international competitiveness and further improving Scotland's environment. The Scottish Enterprise Network (SEn Network) comprises Scottish Enterprise National (SEN) and 12 Local Enterprise Companies, together with their respective subsidiaries. SEN undertakes national and strategic projects directly and is also responsible for leadership, support and control of the SEn Network. SEN annually contracts with LECs for the implementation of strategy at a local level, through the delivery of a wide range of business development and training services, and environmental and regeneration programmes.

2. The Scottish Executive's expectations of SEn are set out in *'A Smart, Successful Scotland – Ambitions for the Enterprise Networks'*, published in October 2001. This sets out SEn's strategic direction in terms of three themes and 12 priorities, reflecting a desire for growth in economic productivity and international competitiveness. How SEn intends to translate these themes and priorities into action is set out in its annual Operating Plan. The Operating Plan for 2002/03 sets out SEn's 22 performance targets which the Scottish Ministers agreed for that year (Appendix 1).

3. During February and March 2003, a number of reports appeared in the media concerning the performance of SEn. These attracted significant attention and led to a Member of the Scottish Parliament suggesting that I undertake an investigation into the management of SEn.

4. There were five broad areas of concern:

   - The extent to which SEn was on-course to achieve its performance targets for 2002/03
   - SEn's performance in managing major projects which were seen to be critical to its success in furthering the development of Scotland's economy
   - Whether SEn failed to claim £32 million EU funding to which it may have been entitled
   - SEn's use of external consultants to help develop its operations
   - The number of staff employed in 'customer relations', in particular SEn's Public Relations Department.

5. Consequently, I asked Audit Scotland[1] to examine these concerns and consider whether any wider issues arose. The auditors of Scottish Enterprise had, as part of their normal risk assessments, previously identified a number of the areas of concern and reviews were planned as part of the 2002/03 audit. This report, which I have prepared under Section 23(1) of the Public Finance and Accountability (Scotland) Act 2000, is based on the auditors' findings from their review. The content is restricted to the five areas outlined above. My report is not therefore a comprehensive review of the management and performance of SEn.

Targets and performance monitoring

6. It was initially claimed that SEn was set to miss eight out of 12 key performance targets in 2002/03 (later revised to nine out of 12). While the SEn Network was on course to achieve 21 of the 22 targets set for it as a whole, this was largely due to LECs achieving or exceeding their targets.

7. The SEn Board is responsible, with the approval of Ministers, for determining the strategic direction for SEn within the overall framework of the three themes and 12 priorities for action set out in *'A Smart Successful Scotland'.* The SEn annual Operating Plan sets out what it plans to deliver in the year ahead. Specific outputs are described in terms of key priority performance targets. The targets are determined through internal discussion and through discussions with the Scottish Executive Enterprise Transport and Lifelong Learning Department (ETLLD), and are ultimately subject to the approval of Ministers.

8. The number of key performance targets varies annually, reflecting changing priorities and strategic aims. For 2002/03, 22 key priority performance targets were set for the SEn Network as a whole. Both SEN and the LECs are expected to contribute to the achievement of the targets set. SEN was expected to directly contribute to the achievement of 12 of the 22 targets set for the SEn Network in 2002/03.

9. The auditors confirmed that, based on its data, SEn achieved 21 out of its 22 key performance targets for 2002/03. The only target which was not achieved related to assisting businesses and universities in the commercial application of collaborative research and development ventures. The SEn Network reported that it assisted 46 such ventures in 2002/03 against a target of 50. SEn attributes this to difficult market conditions. SEN recorded that it achieved its planned contribution towards the Network targets in eight out of the 12 targets towards which it was expected to contribute. SEn, however, does not consider that it is appropriate to distinguish between the performance of SEN in assisting the achievement of Network targets and the performance of the SEn Network as a whole. It considers that, given that the organisation operates as "one Network", comparison against the SEn Network targets is the only valid measure of the entire organisation's performance.

[1] Audit Scotland is the appointed auditor of Scottish Enterprise under Section 21(4) of the Public Finance and Accountability (Scotland) Act 2000. The Auditor General for Scotland also appointed Audit Scotland to examine the media concerns and to consider whether any issues arose, under Section 23(8) of the 2000 Act. The auditors reported the results of their examination to the AGS under Section 23(9) of the 2000 Act.

10. The auditors found that the SEn Network's performance against targets was reported regularly to SEn's Board. The auditors, however, expressed a number of concerns about the reporting of performance. In particular:

- The auditors raised questions whether there may be scope for SEn to set more 'stretching' targets because:

    - The planned contribution by LECs and SEN business units exceeded the overall Network target in 16 out of the 22 targets

    - The SEn Network's actual performance in 2002/03 was at least 20% greater than the targeted level of performance set out in the Operating Plan in respect of 15 of the 22 targets

- There are concerns about SEn's management information system. As late as May 2003, this was reporting that for the year ending 31 March 2003 SEN would achieve its planned contribution to only three out of the 12 Network targets towards which it was expected to contribute. SEN eventually recorded that it had achieved its planned contribution towards eight targets

- The subjective nature of some of the performance measures provides scope for differing interpretations as to the extent to which targets are achieved. This could lead to inconsistency in the reporting of performance among LECs and between LECs and SEN

- The auditors were unable, in some instances, to verify the accuracy of reported performance because, for a number of targets, values were based upon in-house assessments with no independent review or verification

- SEn has no information on the cost associated with the achievement of individual targets and does not benchmark its performance.

11. SEn has made a number of points in response to these concerns:

- SEn considers that the setting of targets for an economic development organisation with a range of business activities is challenging, and involves a process of continuous review and refining

- SEn considers it does not benchmark its output targets because there are no appropriate comparators. However, the outcomes the Network is trying to influence are positioned in relation to the best performance of similar organisations who are members of the Organisation for Economic Co-operation and Development. There is ongoing dialogue with other agencies with the SEN approach being considered by others to be among the most advanced

- In SEn's view there is always a balance to be struck between unrealistic ambition and the stretching of performance, and the quantity and quality of what the Network does. Significant overachievement of some new performance measures usually occurs where there is lack of experience as to what a reasonable target might be

- In SEn's view, LECs and SEN business units often plan to do more than the targeted level of performance, to help ensure that Networks target are achieved

- SEn points out that the Operating Plan identifies the cost of addressing the 12 priorities for action, and the specific projects and programmes within each priority

- SEn's considers that it tries to identify targets that will have a real impact on longer term Ministerial ambitions By their nature, the targets tend to address more qualitative aspects of performance and can, therefore, be more difficult to define. SEn acknowledges that this brings with it a degree of subjectivity but considers that the definitions of outputs in place help reduce this to an acceptable level

- SEn considers that it relies on its business units to report performance against targets. It reviews the reported information for reasonableness and, from time to time, looks in detail at some measures.

Management of major projects

12. Media coverage referred to four major national projects where there were concerns about SEn's project management. Concerns were that major projects were close to collapse because of mismanagement and that resources were diverted from elsewhere within the SEn Network. It was also claimed that projects were behind schedule and, in respect of two of the major projects, SEn had failed to claim £32 million European Union (EU) funding to which it may have been entitled. The auditors found that while some projects had been subject to challenge or delay, or had failed to achieve job targets, SEn is making progress in a number of key areas.

Redistribution of budgets

13. The auditors found that during 2002/03 all business units, including LECs and SEN, had budgets reduced or sums clawed back to finance the major projects. This was in accordance with previously established practice, and in line with the SEn Board's desire for more flexible processes to meet new and emerging priorities and unforeseen demands on the budget. The arrangement, which recognises the dynamic nature of SEn's business, allows any underspend occurring across the SEn Network to be redistributed to meet emerging pressures elsewhere.

14. In total, during 2002/03, £16.3 million was reallocated between SEN and LECs to meet emerging pressures, including pressures on major projects. In 2003/04, SEN business teams and LECs face further budget cuts compared to 2002/03 levels, to allow a planned £25 million increase in expenditure on major projects in accordance with SEn's allocation of resources to strategic priorities.

Progress on individual major projects

Project ATLAS (Accessing Telecom Links Across Scotland)

15. SEn considers Project ATLAS to be a key component in increasing the competitiveness of Scotland's business community through the adoption of e-business. Phase 1 of the project involves the provision of a Telecom Trading Exchange (TTE) and IT link to London. Phase 2 aims to create a telecom network of 13 business parks across Scotland.

16. The auditors found that SEn has contracted with a private sector company to operate the TTE, with the associated website going live in December 2002. SEn has spent £3.5 million on this phase of the project to date which is within budget. SEn's Board approved phase 2 of the project in October 2002 with a budget of £26.7 for capital works and £4 million for operating costs over the first three years of the project's life. After a competitive tendering exercise, SEn selected a private sector company to design, build and operate the network of links to the business parks in November 2002. To date, phase 2 of the project has cost £925,000.

17. SEn recognised that its support for Project ATLAS could be construed as state-aid by providing a competitive advantage to certain businesses which had immediate access to the TTE or to the telecom network established in the 13 business parks. It therefore contacted the EU regarding the project in September 2001. The EU confirmed in December 2001 that phase 1 of the project would not, in principle, give rise to any state-aid issues.

18. SEn formally notified the second phase of the project in February 2003 so that the EU could finally resolve the issue of state-aid. Pending an EU decision as to whether this phase of the project breaches state-aid provisions, SEn has decided not to sign any of the phase 2 contracts. This delay has the potential to endanger the originally planned completion date of October 2004 for phase 2 of the project. SEn considers it is ready to deliver the project as promptly as possible once the state-aid issue has been resolved.

Pacific Quay

19. Pacific Quay is a 26.5 hectare development in the Govan district of Glasgow. A key part of the project is the building of the Glasgow Science Centre. The Centre was completed in June 2001 at a total cost of £73.7 million of which £18.2 million was to be funded from the European Regional Development Fund (ERDF). ERDF funding was subject to the achievement of five main conditions, with failure to comply potentially requiring SEn to repay ERDF funds. Media coverage claimed that the project has

not achieved job creation targets, consequently raising the possibility of SEn being required to repay ERDF grant.

20. By November 2002, SEn had met four of the five main conditions. The remaining condition was the creation of around 3,600 new jobs by the end of 2006. As at 31 December 2002, 299 net new jobs had been created against a profiled target of about 1,600. SEn considers that the fewer than expected number of new jobs created was due to a combination of unforeseen market failures resulting in low levels of private sector investment, and the unforseen importance of a new bridge to be constructed over the River Clyde to access the site. The timing of private sector investment and planning decisions relating to this bridge were not within SEn’s control.

21. In May 2003, in response to SEn’s revised job projection of 1,881 by 2006, the EU agreed to consider a revision of the jobs target subject to the submission of a detailed cost benefit analysis and a sound rationale for revised employment targets and timings to 2012. The EU has not made specific reference to any prospective requirement for SEn to repay grant. SEn, therefore, considers that, subject to the achievement of the revised job target and the financial viability of the Glasgow Science Centre, the question of repayment of ERDF monies will not arise.

22. SEn developed the Glasgow Science Centre in anticipation that it would act as a catalyst for general development on the site. Levels of private sector investment have been lower than expected, but SEn considers that, now that planning permission exists for the construction of the Finnieston Bridge, the amended job creation target will be achieved.

Submission of applications for EU monies

Scottish Co-Investment Fund

23. SEn established the Scottish Co-Investment Fund in November 2002 to provide equity investment of up to £0.5 million in companies in the early stages of growth. SEn plans to contribute £20 million to the Fund over the three years to 2004/05 to fill a recently recognised gap in the venture capital market in Scotland. SEn intends that private sector investors will at least match its contribution from the Scottish Co-Investment Fund in all cases where investment in businesses is made.

24. Private sector investors willing to participate were able to register with SEn between November and December 2002. SEn has now signed contracts with 14 private sector investors providing £19.8 million for potential investment. The first investments in businesses have now been made. SEn will provide £1.3 million to nine companies matched by £4.2 million from private sector investors.

25. The alleged failure of Scottish Enterprise to claim EU funding to which it may be entitled refers to the 2002-2006 Risk Capital Programme of the ERDF, which allocated £32 million to those areas of Scotland within SEn’s operating remit. SEn applied for £25 million of this allocation in April 2003, based

on its assessment of the maximum that could be claimed given current regulations and the matched funding available. SEn has recently advised that the EU has now confirmed that this application has been successful and SEn expects to receive the funds before the end of 2003. SEn informed the auditors that it could not apply for this funding before April 2003 because checks had to be performed on prospective private sector partners which SEn could only have commenced once they had registered with the project. The auditor concluded that the alleged failure of SEn to apply for £32 million EU funding is unfounded.

Intermediary Technology Institutes

26. Intermediary Technology Institutes (ITI) are intended to bridge the gap between research carried out by academic research institutes and company led research and development in new emerging markets. Their function will be to identify and commission pre-competitive research. The SEn Board gave formal approval for the further development of the project in March 2002.

27. The first three ITIs will form part of a company limited by guarantee. In October 2002, the SEn Board approved a start-up budget of £3.9 million for the venture with a further commitment of £12.7 million for 2003/04 operations. SEn has already spent £2.1 million on feasibility and development work. SEn informed the auditors that it had not applied for EU funding for this phase of the project as the nature of the start-up costs make it ineligible for assistance.

28. This is a long-term project which will be slow to generate income from membership fees from participating companies. SEn, therefore, expects to provide in the region of £450 million core funding over the next 12 years. It will also apply for funding from the Department of Trade and Industry, ERDF and various European research programmes as individual research programmes are commissioned. SEn, however, still expects to be providing core funding 20 years from now. The auditors identified that a number of stages in the project were slightly behind schedule, although progress has been made recently by a number of appointments to key posts. SEn still expects to achieve its target of having the first piece of research commissioned by the end of 2003.

Other EU funding issues

29. Although not directly related to major projects, the auditors also referred to an associated area of concern regarding SEn's applications for EU funding. In particular, the auditors noted an internal SEn report of September 2002 to SEn's corporate management team which concluded that, although the Network's past performance in accessing European funding was relatively good, potential funding opportunities may have been missed. The report noted that, during 2001/02, SEn did not appear to have considered the scope for EU funding in respect of the financing of 13 projects. SEn may have been able to secure EU funding of £8 million for these projects. Reasons for not pursuing potential funding opportunities included that the funding available was too small to justify applications, the

complex management and administrative processes associated with pursuing national policies within a regional Objective 2 structure, and the need for a fast response to events.

30. In response to the auditors' enquiries, SEn reviewed further the projects included within the September 2002 report. It concluded that, although not documented at the time, in most cases the EU funding opportunity was considered and dismissed either because an application could not be justified, or because it was impractical to submit an application for reasons of timing or disproportionate administration. The auditors noted that SEn had reviewed its processes for securing EU funding, and that it has taken action to secure improvements in this area.

Use of consultants

31. Media reports expressed concern about the level of SEn's expenditure on consultants and whether this represented an effective use of public money. The auditors examined:

- Expenditure on consultants
- SEn's classification of expenditure on consultants in its financial ledger
- The process for engaging consultants and controlling expenditure
- Particular concerns relating to the financial standing of the Premier Advisor project.

Levels of consultancy expenditure and appropriateness of expenditure classification

32. SEn normally commission consultants and contractors either because there is a lack of in-house expertise in the area under consideration, or insufficient in-house staff resources are available with the expertise necessary to allow projects, programmes and initiatives to be developed and delivered in a timeous manner. In many cases the expertise required is specialised of project specific and SEn considers it would be inappropriate to employ a permanent staff member given the short-term requirement for the expertise. Since its inception, SEn has taken the view that, wherever possible, the private sector would be used to deliver the Network's services where this represents value for money.

33. The SEn Network's expenditure on consultants has more than doubled since 1999/2000 to £43.7 million in 2002/03. A further £63.8 million was spent on contractors in 2002/03. The total of £107.5 million spent on consultants and contractors in 2002/03 represented some 21% of total Network management and operating expenditure. The time spent by consultants and contractors on SEn activities in 2002/03 was the equivalent of employing approximately 1,000 full-time staff.

34. SEn attributes a significant part of the increase in expenditure on consultants to its Business Transformation project. SEn expects the project to introduce changes to its internal systems and working methods, improving efficiency and customer focus and resulting in SEn becoming the world's leading e-enabled economic development agency. SEn estimates the project will produce cost savings and productivity improvements totalling around £200 million by 2006. SEn considers that the Business Transformation project is wide ranging, pioneering and highly complex and, as such, makes extensive use of consultants who have specific expertise in this area.

35. SEn staff can find it difficult to interpret guidance on the classification of consultant and contractor expenditure because of the mix of activities. The auditors found that in 2002/03, following a detailed internal review, SEn reclassified £6.2 million of consultant expenditure in 2002/03 more appropriately as contractor expenditure to provide a more accurate analysis. SEn issued revised guidance in April 2003.

Monitoring and control of consultant expenditure

36. The auditors found that between June 1999 and April 2003 management information on consultant/contractor spend was not routinely provided to either SEn's Board at its request, or to management. SEn considers that such expenditure is more appropriately monitored and controlled as part of the reporting of expenditure at project and/or programme level. The auditors consider that spending on consultants and contractors should be regularly reported to SEn's Board and management because it has been increasing significantly and is central to how SEn operates. SEn has now undertaken to review how this information could best be presented to the Board in future.

37. The auditors also reviewed 10 consultancy contracts administered by SEN to determine whether procedures for the appointment of consultants and contract monitoring met SEn's internal guidance and accepted best practice. The contract values ranged from £40,000 to over £10 million. The auditors concluded that SEn should improve its practices and compliance with procedures.

Main contract for the Business Transformation project

38. SEn required tenderers for the main consultancy contract for the Business Transformation to specify the functions of named individuals who would work on the contract, the duration of their involvement and their cost. The tender document set out that the contract would 'ideally' be let on a fixed term basis and would comprise two main functions, 'transformation partner' and 'subject matter specialists'. SEn was to assess the tenders received using a points system, with 65% of the total points being attributed to quality factors and 35% to cost.

39. SEn concluded that the two tenders submitted satisfied the quality criteria. The main differentiating factor between the two tenders was, therefore, cost. The first tenderer had previously been involved in an earlier phase of the Business Transformation project. It estimated that it would spend about 9,400

days on the contract and costed its involvement at £18.5 million. The second tenderer estimated it would spend approximately 2,000 days on the contract but did not provide an overall cost. As part of their examination, the auditors costed the second tender at £2.7 million. The second tender was significantly cheaper that the first, not only because the second tenderer forecast spending fewer days on the project, but also because it was offering a greater discount on its standard daily fee rates.

40. Because of the large variation in the number of days anticipated to be spent on the contract, SEn held a series of meetings with the second tenderer to ensure it had a full understanding of the scope of the work to be undertaken. As a result, the second tenderer's forecast of the time to be spent on the contract was increased to about 3,670 days. SEn also undertook a sensitivity analysis of the 'transformation partner' element of the second tender and compared this with the 'transformation partner' element of the first tender. SEn took the second tenderer's revised number of days to be spent on the contract as a 'best case' scenario and further increased these by 28% and 82% to provide 'most likely' and 'worse case' scenarios. By multiplying these scenarios by the second tenderer's daily fee rates, SEn calculated the 'transformation partner' element of the second tender as ranging from £3.6 million to £6.5 million. On the basis of this work and the assessment of quality factors, the SEn Tender Board accepted the second tenderer's bid on a 'time and materials' basis.

41. The auditor had a number of concerns relating to the process for awarding the contract:

- Because the two tenders were submitted on different bases, their financial comparison was restricted to the 'transformation partner' element of the project. The comparison took no account of the second tenderer's original estimate of the number of days to be spent on the project

- SEn decided that it would not be feasible, initially, to let the contract on a fixed term basis. It intended, therefore, to implement the fixed price arrangement in due course for all or some of the project. In the event, the contract proceeded on a 'time and materials' basis for its duration

- To date, SEn has paid £10.8 million under the contract with the final projected value being £11.9 million. The contract is, therefore, significantly cheaper than that contained in the unsuccessful tender. Despite this, the auditor could not conclude that SEn achieved the most economically advantageous deal because of the entirely different bases on which the two tenders were evaluated. In addition, shortly before it was signed, SEn refined and developed the contract to an extent that it altered significantly from that indicated in the initial tender documents. This rendered any comparison with the unsuccessful tenderer impossible. SEn, however, considers that the successful contractor was a more cost-effective solution and that it received value for money from the process adopted

- The difference between the value of both tenders and the fact that SEn has now made payments to the successful contractor which are substantially in excess of that quoted in the original tender, casts significant doubts as to whether SEn and the successful contractor were fully aware of the scope and extent of the work required. SEn maintains that, although the detailed arrangements still had to be worked out, the successful contractor was fully aware of the effect of the proposed changes to the scope of the contract

- Due to competing work pressures, SEn was unable to release all 100 of its own staff, as originally intended, to work on the project. This resulted in additional consultancy support being required

- Given the large scale and nature of the project, the decision to award the contract on a 'time and materials' basis may not have allowed for appropriate risk-sharing, nor provided sufficient incentive to the successful contractor to limit its input to the project.

Other areas of concern

42. The auditor also identified a number of other areas of concern regarding SEN's management of consultancy contracts:

    - Signed contracts could not be produced in respect of three contracts. In a further case, the main consultancy contract for the Business Transformation project, the contract was not signed until 18 months after work commenced and only two months before the contract was due to be completed. In the latter contract, SEn accepts that the process for agreeing and signing the contract should have been accelerated. But it considers that both parties had a clear understanding of their obligations, and that the contractor fully accepted the principal conditions contained in the draft contract

    - In three instances, SEn could not demonstrate that it had formally considered and justified its decision to award contracts without exposure to competition. SEn maintains that in two of the three cases, the decision to award the contract without competition was justified, albeit the decision was not adequately documented on project files

    - In the auditor's view a project for the purchase of new business software appeared to have been artificially split into a number of separate contracts so as to avoid the need for higher-level authorisation for the project. SEn does not agree with the auditor's view but accepts there is a need for greater clarity in its project planning and approval processes

    - One contract, initially awarded for £1.2 million, was extended without being further exposed to competition. SEn eventually paid the consultants £4.7 million through a series of approved variation orders for additional work. SEn considers that it always considers exposing further work to competition but, inevitably, a proportion of the additional work is awarded to the original contractor due to their knowledge and experience of the project. SEn is, however, developing new procedures intended to improve tendering arrangements

- In two contracts, SEn obtained informal legal advice that it was not necessary to advertise in the OJEC European Journal. It did not, however, retain details of the advice on file. Also in two contracts, SEn did not comply with requirements to advertise the successful tenderer in OJEC. In a further two cases, SEn did not seek prior ETLLD approval to accept or extend high value contracts. Subsequent to the auditors' investigations, SEn obtained formal legal advice that it was not necessary to advertise the two contracts in OJEC. ETLLD also gave retrospective approval for both the high-value contracts

- In only one case did SEn comply with its internal procedures to undertake an assessment of the financial viability of tenderers. There was also significant variation in approaches to the evaluation and comparison of bids.

Premier Advisor programme

43. The Premier Advisor programme is designed to train individuals who will improve SEn's service delivery through providing enhanced business advice. Concerns were expressed about a number of aspects of the financial management of the programme:

    - It was claimed that the main contractor for the programme has had the contract since 2000, and the contract is renewed annually without competition

    - It was claimed that the average cost per trainee processed was around £20,000 to £25,000

    - It was claimed that former employees are being granted consultancy contracts on favoured terms

    - It was claimed that six consultants were flown to Hong Kong for a week to train three SEn staff. The consultants spent a week on this training when they would normally only spend a couple of days

    - It was claimed that, SEn had withheld payments to contractors because the project had exceeded its 2002/03 budget by January 2003.

44. The auditors found that most of the concerns surrounding the Premier Advisor project were unfounded. SEn awarded the contract to administer the programme to the lowest bidder through a competitive tendering exercise. For operational reasons, the contract was let initially only for the first year of the project. SEn was satisfied with the contractor's performance and awarded a further one-year contract without competition. To date, 360 advisors have been trained at a cost of £8,000 each. The final number of trained advisors is expected to be around 520 at a cost of £6,020 each.

45. Former SEn employees were not granted consultancy contracts on favoured terms. Two former employees of LECs are providing training but were appointed after a competitive tendering exercise.

Trainers did visit in Japan to train members of SEn's office located there, but fewer in number and for less time than was claimed.

46. The auditors did, however, find that SEn did not pay invoices submitted in January 2003 to the value of £167,000 because the Premier Advisor programme had exceeded its original £2.1 million budget. There were also delays in applying for additional EU funds. SEn paid the invoices in June 2003 once additional budget approval was received from the SEn Board.

Customer relations staffing

47. The auditors confirmed that the overall establishment for SEn's Customer Relations department is 92, excluding six staff who provide services direct to Careers Scotland. The establishment comprises a core staff complement of 62. A further 30 posts had been agreed as part of SEn's Business Transformation project to service the new Network-wide customer management operation. SEn considered that these new posts would enable it to respond more quickly to customer inquiries, and to provide relevant information and services that more closely match customers' needs. SEn expects this will result in productivity savings.

48. Of the 92 staffing complement, 71 staff are in post with 21 posts vacant. The Business Transformation projects accounts for 19 of the unfilled posts. SEn is now reconsidering whether to fill these posts, in light of changing operational need. The auditors concluded that the Customer Relations department has a wider remit than the press and public relations activities which may be inferred from the media coverage.

Conclusions and recommendations

Targets and performance monitoring

49. The Scottish Executive has set the strategic direction for SEn in the form of three themes and 12 priorities based upon '*A Smart Successful Scotland*'. SEn translates these into priorities for action in its annual Operating Plan which, for 2002/03, sets outs 22 performance targets.

50. The auditors confirmed that, based on its data, SEn achieved 21 out of its 22 key performance targets for 2002/03. SEn reported this level of achievement to its Board and in its annual report. The auditors, however, reported concerns about SEn's management information system which, as late as May 2003, was reporting that SEN would achieve its planned contribution to only three out of 12 Network targets to which it was expected to contribute in 2002/03. SEN eventually recorded that it had achieved its planned contribution towards eight targets. The auditors did not review in detail the systems for collecting and reporting performance information and I shall consider including a detailed review of SEn's performance management and accountability

arrangements in my forward programme of performance audit examinations.

Management of major programmes

51. While some major projects have been subject to delay or have not achieved targets for job creation, the auditors reported that progress has been made in a number of key areas. SEn often pump-primes private sector business investment and development. It does not, therefore, always have complete control over the outcomes of its activities.

52. During 2002/03, SEn reduced budgets in some areas of its activities and reallocated money to other areas. While some of the budget reallocations were directed towards major projects, budget reductions were generally confined to areas of underspend. It is right that public bodies maintain a close review of expenditure against budget. Provided that management are clear about the reasons for over and underspends, the reallocation of budgets is part of good financial management.

53. Pacific Quay is a very large development in Glasgow which includes the Glasgow Science Centre. SEn has met four of the five main conditions for ERDF funding, but the job creation targets for the project have been revised downwards and the Science Centre is not performing in line with expectations. I shall ask the auditors to keep under review progress in relation to Pacific Quay and the Science Centre and I may report on this project at a later date.

54. The project to create and fund Intermediary Technology Institutes will require a very large commitment of public funds amounting to core funding of £450 million over the next 12 years. I have asked the auditors to keep under review the progress which is made and the results delivered from this substantial project.

55. While I expect the auditors to continue to review and report progress on all significant projects as part of their on-going audit of SEn, the responsibility lies with the management and Board of SEn to monitor performance against project targets and to take corrective action when necessary.

Applications for EU funding

56. It appears from SEn's own internal review that SEn may not have applied for all the EU funding to which it may have been entitled. The auditors reported that SEn was taking steps to strengthen its processes in this area. The media concern that £32 million of EU funding was not applied for is, however, unfounded. EU money can be an important funding source and public bodies should ensure that the potential availability of EU funding is considered at all stages of the development of new projects. Sometimes the amounts involved may not justify the efforts involved in applying but there should be procedures for recording any decisions not to apply in

cases where EU funding may be available.

Use of consultants

57. SEn makes extensive and increasing use of consultants and contractors. In 2002/03 this expenditure amounted to £107.5 million, over one-fifth of total Network management and operational expenditure. In my opinion, it is reasonable to expect the SEn Board and senior management to monitor this very large and growing area of expenditure. It is, therefore, of concern that for a period of almost four years until April 2003, no management information on the use made of consultants and contractors was provided to the Board and senior management.

58. SEn is currently implementing a Business Transformation project which is expected to improve business efficiency and effectiveness. This is a significant project on which SEn has paid consultants over £11 million to date. SEn considers that the project has contributed to a reduction in the number of staff employed in the Network. Consultants may be best placed to provide the required services but they are generally more expensive than in-house staff. SEn should, therefore, consider carefully the costs and benefits of further staff reductions if there is a risk that a move to externally sourced services might involve higher costs. The auditors will, therefore, consider SEn's recruitment of consultants and contractors as part of a future review of the Business Transformation project.

59. Based on the auditors' review of 10 consultancy contracts, including the Business Transformation contract, I have some concerns about the way that SEn appoints and monitors consultants. I note that SEn has developed a 19-point action plan designed to address the identified weaknesses. The auditors will return to this area at a later date to ensure that action has been taken and that SEn is complying with its own guidance and best practice.

Part 1: Introduction

1.1 Scottish Enterprise (SEn) is a non-departmental public body sponsored by the Scottish Executive Enterprise, Transport and Lifelong Learning Department (ETLLD). Under the Enterprise and New Towns (Scotland) Act 1990 it is responsible for:

- Furthering the development of Scotland's economy and in that connection providing, maintaining and safeguarding employment
- Enhancing skills and capacities relevant to employment in Scotland and assisting persons to establish themselves as self-employed persons there
- Promoting Scotland's industrial efficiency and international competitiveness
- Furthering improvement of the environment of Scotland.

1.2 The Scottish Enterprise Network (SEn Network) comprises Scottish Enterprise National (SEN) and 12 Local Enterprise Companies (LECs), together with their respective subsidiaries. SEN undertakes national and strategic projects directly and is also responsible for leadership, support and control of the SEn Network. SEN annually contracts with LECs for the implementation of strategy at a local level, through the delivery of a wide range of business development and training services, and environmental and regeneration programmes.

1.3 The Scottish Executive's expectations of the Enterprise Networks[2] are set out in *'A Smart, Successful Scotland – Ambitions for the Enterprise Networks'*, published in October 2001. This sets out SEn's strategic direction in terms of three themes and 12 priorities, reflecting a desire for growth in economic productivity and international competitiveness (Exhibit 1). How SEn intends to translate these themes and priorities into action is set out in its annual Operating Plan. The Operating Plan for 2002/03 sets out SEn's 22 performance targets which the Scottish Ministers agreed for that year (Appendix 1).

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[2] i.e. Both the Scottish Enterprise Network and the Highlands and Islands Enterprise Network

Exhibit 1

Themes and priorities for the Scottish Enterprise Network

Themes	Priorities
• Growing businesses (raising the long run sustainable growth rate of the Scottish economy)	• Greater entrepreneurial dynamism and creativity
	• More e-business
	• Increased commercialising of research and innovation
	• Global success in key sectors
• Global connections (ensuring Scotland is a globally connected nation)	• Digital connectivity
	• Increased involvement in global markets
	• Scotland to be a globally attractive location
	• More people choosing to live and work in Scotland
• Learning and skills (raising the employment rate across Scotland)	• Improving the operation of the Scottish labour market
	• The best start for all our young people
	• Narrowing the gap in unemployment
	• Improving the demand for high quality in-work training

Source: *'A Smart, Successful Scotland – Ambitions for the Enterprise Networks'* ,Scottish Executive, October 2001

1.4 During 2002/03, SEn's expenditure was £496 million. Of this, £272 million (55%) was paid to LECs. The management and administration fees of SEN and the LECs amounted to £129 million (26%). Grant-in-aid of £425 million was the biggest source of income, with the balance of funding including rental and other property services income, Careers Scotland funding contributions, and other funding. European Union (EU) funding amounted to £14 million.

1.5 During February and March 2003, a number of reports appeared in the media concerning the performance of SEn. These attracted significant attention and led to a Member of the Scottish Parliament suggesting that I undertake an investigation into the management of Scottish Enterprise.

1.6 There were five broad areas of concern:

- The extent to which SEn was on-course to achieve its performance targets for 2002/03
- SEn's performance in managing major projects which were seen to be critical to its success in furthering the development of Scotland's economy
- Whether SEn failed to claim £32 million EU funding to which it may have been entitled

- SEn’s use of external consultants to help develop its operations

- The number of staff employed in ‘customer relations’, in particular SEn’s Public Relations Department

1.7 Consequently, I asked Audit Scotland, as the appointed auditor of SEN, to examine these concerns and consider whether any wider issues arose. The auditors had, as part of their normal risk assessments, previously identified a number of the areas of concern and reviews were planned as part of the 2002/03 audit.

1.8 This report, which I have prepared under Section 23(1) of the Public Finance and Accountability (Scotland) Act 2000, is based on the auditors’ findings from their review. The content is restricted to the five areas outlined above. My report is not therefore a comprehensive review of the management and performance of SEn.

Part 2: Targets and performance monitoring

Issue

2.1 Media coverage included concerns that SEn was set to miss eight out of 12 key performance targets for 2002/03 (later revised to nine out of 12). While the SEn Network was on course to achieve 21 of the 22 targets set for it as a whole, this was largely due to LECs achieving or exceeding their targets.

2.2 Audit Scotland's audit plan for 2002/03 included a commitment to examine the SEn's performance measurement systems. This work was therefore extended to include a review of SEn's reported outturn against targets, and its processes for monitoring and reporting performance.

Audit findings

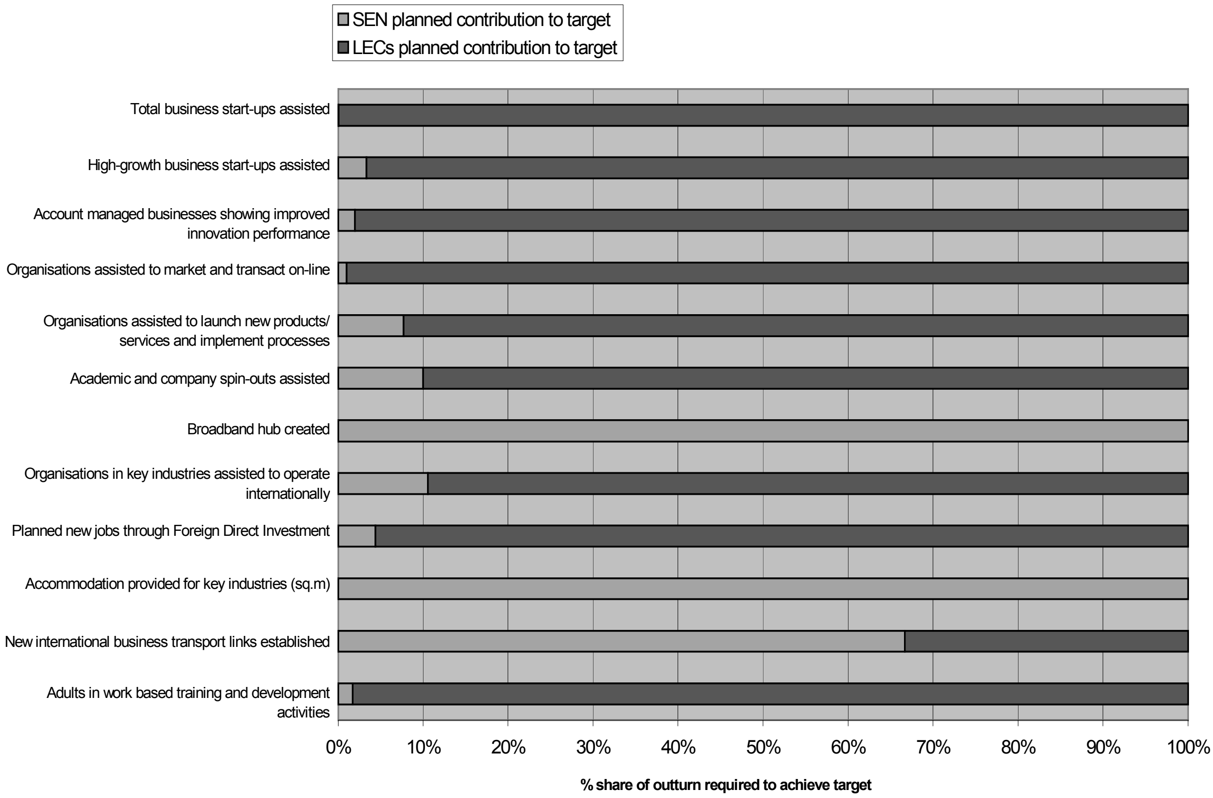
Background

2.3 The SEn Board is responsible, with the approval of Ministers, for determining the strategic direction for SEn within the overall framework of the three themes and 12 priorities for action set out in *'A Smart Successful Scotland'.* The SEn annual Operating Plan sets out what it plans to deliver in the year ahead. Specific outputs are described in terms of key priority performance targets. The targets are determined through internal discussion and through discussions with ETLLD, and are ultimately subject to the approval of Ministers.

2.4 The number of key performance targets varies annually, reflecting changing priorities and strategic aims. For 2002/03, 22 key priority performance targets were set for the SEn Network as a whole. SEn submits reports on the Network's performance against targets to its Board on a monthly basis during the second half of the operating year. Reports of outturn against targets are made available to staff via the SEn intranet site. SEn also provides copies of all Board papers to ETLLD including details of performance. More recently, however, ETLLD has asked that a separate report on performance be submitted.

2.5 Both SEN and the LECs are expected to contribute to the achievement of the targets set. SEN was expected to directly contribute to the achievement of 12 of the 22 targets set for the SEn Network in 2002/03. In most cases, SEN was expected to contribute less than 10% to the overall level of outturn required to achieve the target (Exhibit 2). This, in part, reflects SEN's function as a headquarters, providing services such as finance, legal, and customer relations across the SEn Network rather than, generally, as a front-line delivery agent.

Exhibit 2
SEN's planned contribution to the Network targets 2002/03



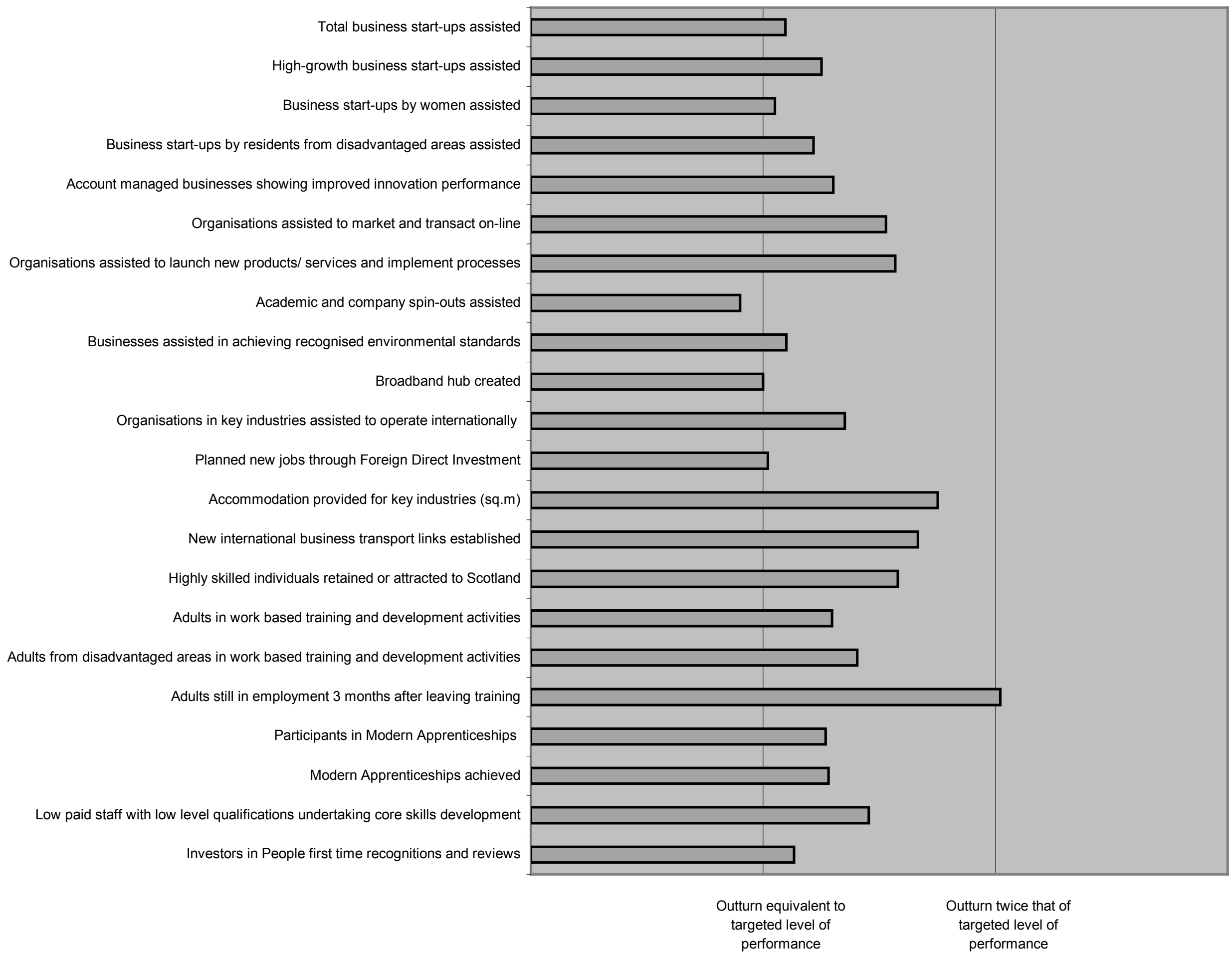
Source: Audit Scotland

2.6 SEn does not consider that it is appropriate to distinguish between the performance of SEN in assisting towards the achievement of Network targets and the performance of the SEn Network as a whole. It considers that comparison against the SEn Network targets is the only valid measure of the entire organisation's performance. In its view, given the way in which the SEn Network operates, SEN contributes to more of the targets that it records a contribution against. For example, in helping Scottish companies internationalise, Scottish Development International (part of SEN) makes a significant contribution alongside the LECs, but the output achievement is recorded against the LEC where the company supported is located. SEn considers that this "one Network" approach, involving joint working between business units in pursuit of Network goals, is central to its operational philosophy.

Levels of reported performance

2.7 The auditors confirmed that, based on its data, SEn achieved 21 out of its 22 key performance targets for 2002/03 (Exhibit 3 and Appendix 1). The only target which was not achieved related to assisting businesses and universities in the commercial application of collaborative research and development ventures. The SEn Network reported that it assisted 46 such ventures in 2002/03 against a target of 50. SEn attributes this to difficult market conditions. In 2000/01 and 2001/02, SEn reported that it had achieved 15 out of 20 targets and 18 out of 21 targets respectively.

Exhibit 3
Scottish Enterprise Network performance against targets 2002/03

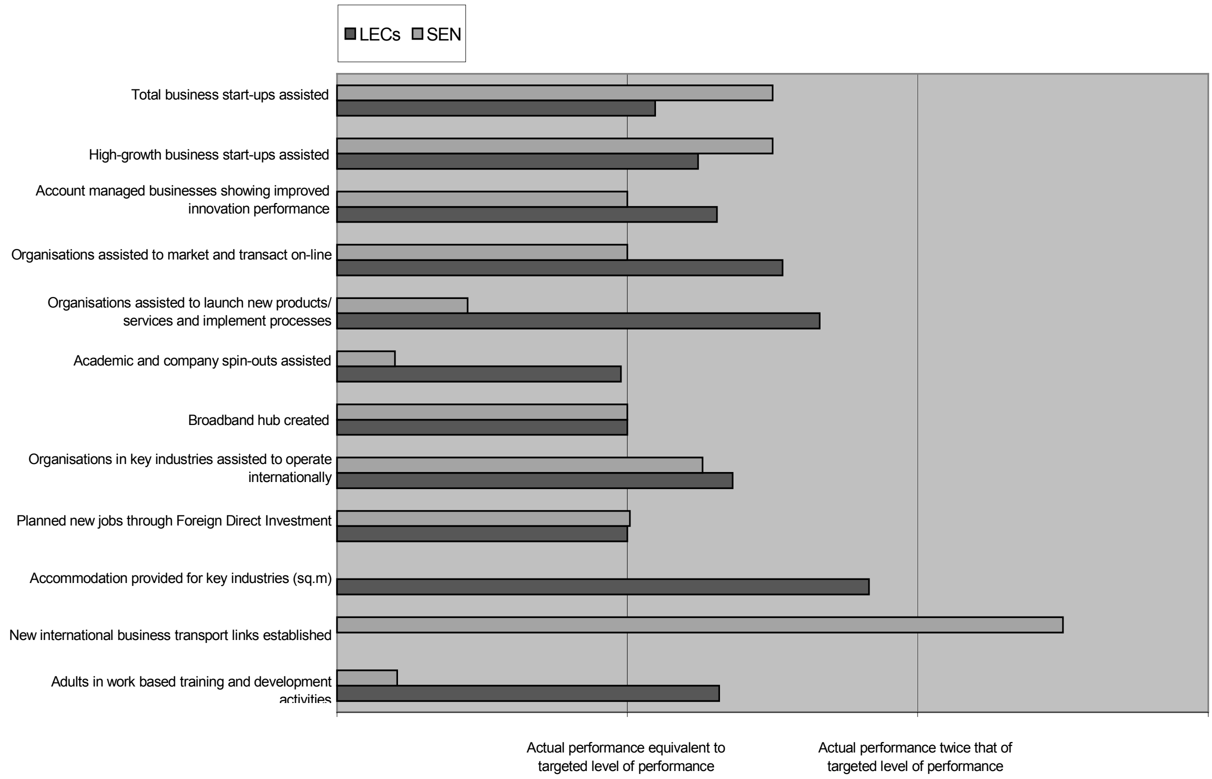


Source: Audit Scotland

2.8 SEN recorded that it achieved its planned contribution towards the Network targets in eight out of the 12 targets towards which it was expected to contribute in 2002/03 (Exhibit 4). This represents a significant improvement from the provisional outturn which SEn reported to its Board in May 2003 when it forecast that SEN would only achieve its planned contribution towards three of the 12 targets.

Exhibit 4

Comparison of performance against targets for the 12 targets to which SEN was expected to contribute in 2002/03



Source: Audit Scotland

Auditors' concerns about SEn's performance reporting arrangements

2.9 Based on their review, the auditors expressed a number of concerns relating to SEn's setting of performance targets and about its monitoring and reporting of performance.

The scope for more 'stretching' targets

2.10 SEn management monitors overall performance against the Network targets which appear in the annual Operating Plan. SEn management also monitors the performance of individual LECs and SEN business units in contributing towards the Network targets. The planned contributions to the Network targets are set by the management of LECs and business units based on their views as to what is achievable within the available financial resources. The auditors' analysis of the SEn Network's performance led them to raise questions whether there may be scope for SEn to set more 'stretching' targets. In particular:

- During 2002/03, the aggregate of the planned contributions which LECs and SEN business units expected to make exceeded the overall Network target in 16 out of the 22 targets set out in the Operating Plan (Exhibit 5)

- During 2002/03, actual performance exceeded the targeted level of performance by at least 20% in 15 of the 22 Network targets. During the previous two years, actual performance exceeded the targeted level of performance by at least 20% in four out of 20 Network targets and 10 out of 21 Network targets respectively

- When compiling its Network targets, SEn does not carry out any benchmarking to inform what a challenging but achievable level of performance should be.

Exhibit 5

Comparison of Network targets against the aggregate of LEC's and SEN business unit's planned contributions 2002/03

Network targets where aggregate of LEC's and business unit's planned contributions was equal to or less than the targeted level of performance • Total business start-ups assisted • Business start-ups by women assisted • Business start-ups by residents from disadvantaged areas assisted • Broadand hub created • New international business transport links established • Adults in work based training and development activities
Network targets where the aggregate of LEC's and business unit's planned contributions exceeded the targeted level of performance by up to 10% • High-growth business start-ups assisted • Account managed businesses showing improved innovation performance • Organisations assisted to market and transact on-line • Organisations assisted to launch new products/ services and implement processes • Businesses assisted in in achieving recognised environmental standards • Planned new jobs through Foreign Direct Investment • Adults from disadvantaged areas in work based training and development activities • Participants in Modern Apprenticeships • Investors in People first time recognitions and reviews
Network targets where the aggregate of LEC's and business unit's planned contributions exceeded the targeted level of performance by up to 20% • Organisations in key industries assisted to operate internationally • Accommodation provided for key industries (sq.m) • Highly skilled individuals retained or attracted to Scotland • Adults still in employment 3 months after leaving training • Modern Apprenticeships achieved • Low paid staff with low level qualifications undertaking core skills development
Network targets where the aggregate of LEC's and business unit's planned contributions exceeded the targeted level of performance by more than 20% • Academic and company spin-outs assisted

Source: Audit Scotland

2.11 In response, SEn advised the auditors:

- The setting of targets for an economic development organisation with a range of business activities such as SEn is challenging, and involves a process of continuous review and refining

- When compiling the Operating Plan, senior management, the Board and ETLLD invariably question the degree to which Network targets are stretching. During the planning process, targets are often increased from the original business unit proposals

- The fact that the agreed Network target is often less than the aggregate of the planned contribution of LECs and business units is, in large part, due to prudent planning to ensure that the Network target as a whole is met. LECs collectively will often plan to do more than the national target, to help ensure the target is met

- There is always a balance to be struck between unrealistic ambition and the stretching of performance, and the quality and quantity of what the Network does

- Significant over-achievement against the Network target usually occurs where a new measure has been identified, which is considered to be a better proxy for the final outcome sought. In these cases there is little or no previous experience to inform the setting of the target

- The Network does not benchmark its output targets because there are no appropriate comparators. However, the outcomes the Network is trying to influence are positioned in relation to the best performance of similar organisations who are members of the Organisation for Economic Co-operation and Development. There is ongoing dialogue with other agencies with the SEN approach being considered by others to be among the most advanced.

The reliability of SEn's performance reporting systems

2.12 The auditors expressed concern about SEN's management information system which, as late as May 2003, was reporting that for the year ending 31 March 2003 SEN would achieve its planned contribution to only three out of the 12 Network targets towards which it was expected to contribute. SEN eventually recorded that it achieved its planned contribution towards eight targets in 2002/03.

2.13 SEn, however, told the auditors that the main reasons for the reported improvement in SEN's contribution to the targets are a combination of LECs reporting outputs originally planned to be reported by SEN, and the late recording of achievements on the management information system. SEn considers that the profiling of a number of outputs with an increase at the year-end reflects the nature of the work the Network undertakes and the prudent forecasting of when the output will occur. In SEn's view, this is a constantly developing system and the Network is continuously trying to improve its output measures so that they relate as closely as possible to longer term outcomes.

The accuracy of reported performance against targets

2.14 In the auditors' view, the subjective nature of some of SEn's Network targets allows scope for differing interpretations as to the extent to which they are achieved. The auditors consider this can give rise, among other things, to inconsistent reporting of achievements among LECs and between LECs and SEN. SEn, however, told the auditors that its intention is to identify targets which will have a real impact on longer term Ministerial ambitions. By their nature, these often reflect more qualitative aspects of performance and can be more difficult to define. This results in a degree of subjectivity to the targets set but SEn considers that its definitions of outputs helps reduce this to an acceptable level.

2.15 The auditors were unable, in some instances, to verify the reported outturn against targets because of an absence of supporting evidence. For a number of targets, reported performance was based upon in-house assessments with no independent reviews or verification. SEn told the auditors that it relies on LECs and SEN business units to report target achievements, and it reviews the reported information for reasonableness. In some cases, this results in reported outturn being amended. SEN also, from time to time, carries out a detailed examination of reported outturn against some targets.

The cost of achieving targets

2.16 SEn does not collate information on the cost of achieving individual Network targets or other supporting performance measures. In the auditors' view, this precludes any assessment of whether targets have been delivered within planned resources. SEn concedes that it does not undertake a detailed unit cost analysis of each target. But the annual Operating Plan identifies the costs of addressing each of the 12 priorities set out in *'A Smart Successful Scotland'*, and the specific projects and programmes that are expected to contribute towards each priority.

Part 3: Management of major projects

Issue

3.1 Media coverage referred to four major national projects where there were concerns about SEn's project management. Concerns were that major projects were close to collapse because of mismanagement and that resources were diverted from elsewhere within the SEn Network. It was also claimed that projects were behind schedule and, in respect of two of the major projects, SEn had failed to claim £32 million EU funding to which it may have been entitled. The auditors assessed the factual position in relation to:

- The claimed diversion of monies to fund major projects
- Progress on the major projects
- Alleged failures to submit applications for EU monies.

Audit findings

Redistribution of budgets

3.2 The auditors found that the SEn Board decided, in accordance with practice introduced a number of years previously, that funding made available to LECs and SEN business units in 2002/03 would be subject to a 5 per cent clawback provision, enabling the Board to reduce all, or any, budgets should the need arise. The Board also introduced more flexible in-year processes to meet new and emerging priorities, and unforeseen demands on the budget. One of the principles of this new arrangement, which recognises the dynamic nature of SEn's business, was that any identified underspend occurring across the Network would be made available for re-distribution for other purposes. Similar arrangements are expected to apply in 2003/04.

3.3 As at the end of August 2002, SEn identified a number of underspends across SEN business units which were greater than 10 per cent of profiled expenditure and which totalled £10.7 million. At the same time, SEn recognised that a number of operating budgets were experiencing pressures due to the need to revise expenditure plans on certain key projects. SEn therefore decided to reallocate £7 million from the budgets of underspending SEN business units to help meet these demands. The budget reallocation provided three LECs in particular with extra funds totalling £3.1 million. A further £3m was made available for SEn's Project Atlas project.

3.4 SEn further revised its 2002/03 expenditure plans in November 2002, following its review of forecast outturn against budgets. This exercise enabled SEn to identify new pressures on budgets of £22.1 million, with support for major projects representing £3 million of this total. To meet these projected demands, SEn reduced the budgets of all Network business units including LECs by 2.5%, amounting to £5.9 million. Due to slippage and postponement on other projects, a further £3.4 million was released from SEN business units.

3.5 The overall budget for SEn in 2003/04 is £472 million equating to a £8 million increase from 2002/03 levels. Support for major projects will increase from £8 million to £33 million in accordance with SEn's allocation of resources to strategic priorities, while the budgets of other areas of SEn's activities will reduce by £17 million. SEn considers that the transfer of monies from LECs and business teams derives, in part, from the benefits accruing from the Business Transformation programme (see paragraph 4.3), and emphasises that its major projects are intended to bring benefits across the whole of the Network area.

Progress on individual major projects

Project ATLAS (Accessing Telecom Links Across Scotland)

3.6 SEn considers Project ATLAS to be a key component in increasing the competitiveness of Scotland's business community through the adoption of e-business. Media concerns focussed on the risk of slippage to the project due to legal challenge that it is in breach of EU 'state-aid' provisions. The project comprises two distinct phases:

- Phase 1 of the project involves the provision of a Telecom Trading Exchange (TTE)[3] and IT link to London. The SEn Board approved this part of the project in January 2002 at an estimated cost of £6.1 million. SEn has contracted with a private sector company to operate the TTE on its behalf with the website going live in December 2002

- Phase 2 aims to create a telecom network of 13 business parks across Scotland. The SEn Board approved this element of the project in October 2002 with a budget of £26.7 million for associated capital works and £4 million for operating costs over the first three years of the project's life. After a competitive tendering exercise, SEn selected a contractor in November 2002 to design, build and operate the links to business parks.

3.7 SEn recognised that its support for Project ATLAS could be construed as state-aid by providing a competitive advantage to certain businesses which had immediate access to the TTE or to the telecom network established in the 13 business parks. It therefore first contacted the EU regarding the project in September 2001, and met with EU staff three months later. The EU confirmed to SEn in December 2001 that phase 1 of the project would not, in principle, give rise to any state-aid issues.

[3] A TTE is essentially a website where worldwide telecoms companies can post their prices for services

3.8 SEn met with the EU regarding the second phase of the project in January 2003. As a result of these discussions, SEn formally notified the project in February 2003, so that the EU could finally resolve the issue of state-aid. Pending an EU decision as to whether this phase of the project breaches state-aid provisions, SEn has decided not to sign any of the phase 2 contracts. Similarly, in February 2003, the EU approved in principle SEn's application for £4.2 million from the European Regional Development Fund (ERDF) in connection with qualifying infrastructure work at business parks, subject to the satisfactory resolution of the state aid issue. SEn is withholding a further ERDF application for £0.2 million pending the resolution of the state aid issue.

3.9 In May 2003, the EU informed SEn that a telecommunications company, THUS, had approached the EU stating that the project's network infrastructure to 13 business parks (phase 2) restricted competition. In addition, a separate company, Ednet, has also sought clarification about a potential state aid aspect of the TTE.

3.10 The auditors report that the delay in progressing phase 2 of the Project Atlas project has the potential to endanger the originally planned completion date of October 2004. SEn considers it is ready to deliver the project as promptly as possible once the state-aid issue has been resolved. SEn's total expenditure on Project Atlas to date is £3.5 million under phase 1 and £925,000 under phase 2.

Pacific Quay

3.11 Pacific Quay is a 26.5 hectare development in the Govan district of Glasgow. The area used to be dominated by the shipbuilding industry but now suffers complex economic and social deprivation. Media concerns concentrated on the development not achieving job creation targets with the consequential requirement for SEn to repay EU grant, and a high risk of project slippage. SEn divided the site into three major developments:

- The provision of the Glasgow Science Centre
- The creation of a Digital Media Village including accommodation for the BBC and digital media companies
- The creation of a high quality business park designed to build upon the catalytic effects of the other developments, with the project to be taken forward by the private sector.

3.12 A key objective of the project is the building of the Glasgow Science Centre to act as a catalyst for the general development of the Pacific Quay site. Scottish Enterprise Glasgow sponsored the building of the Glasgow Science Centre in 1997. Building commenced in 1999 and was completed in June 2001 at a total cost of £73.7 million of which the ERDF contributed £18.2 million.

3.13 ERDF funding was subject to the achievement of five main conditions, with failure to comply potentially requiring SEn to repay ERDF funds. By November 2002, the EU recorded that SEn had complied with four of the five conditions. The remaining condition was the creation of 3,574 new jobs by the end of 2006. As at 31 December 2002, 299 net new jobs had been created against a profiled target of 1,564. SEn considers that the fewer than expected number of new jobs created was due to a combination of unforeseen market failures resulting in low levels of private sector investment, and the unforseen importance of a new crossing over the River Clyde to access the site. In particular, the BBC was reluctant to commit to a new headquarters on the site until the building of a new bridge had been confirmed.

3.14 In May 2003, in response to SEn's revised job projection of 1,881 by 2006, the EU agreed to consider a revision of the jobs target subject to the submission of a detailed cost benefit analysis and a sound rationale for revised employment targets and timings to 2012. The EU has not made specific reference to any prospective requirement for SEn to repay grant. SEn, therefore, considers that, subject to the achievement of the revised job target and the financial viability of the Glasgow Science Centre, the question of repayment of ERDF monies will not arise.

3.15 The auditors report that the Pacific Quay project has not progressed as well as intended due to lower than expected levels of private sector investment. The timing of private sector investment and planning decisions relating to the new bridge were not within SEn's control. SEn considers that, now that planning permission exists for the construction of the Finnieston Bridge, there is evidence of increased market interest in the site which should create the expected number of jobs in line with the amended target.

Submission of applications for EU monies

Scottish Co-Investment Fund

3.16 SEn established the Scottish Co-Investment Fund in November 2002 to provide equity investment of up to £0.5 million in companies in the early stages of growth. SEn plans to contribute £20 million to the Fund over the three years to 2004/05 to fill a recently recognised gap in the venture capital market in Scotland. SEn intends that private sector investors, such as venture capitalists, business angels and other reputable early stage investment vehicles, will at least match its contribution from the Scottish Co-Investment Fund in all cases where investment in businesses is made. Media concerns focussed on SEn's alleged failure to apply for £32 million EU funding, and a high risk of project slippage.

3.17 Private sector investors willing to participate were able to register with SEn between November and December 2002. This process enabled SEn to identify a number of eligible private sector investors willing to provide investment sums totalling over £80 million. SEn has now signed contracts with 14 private sector investors providing £19.8 million for potential investment.

3.18 The first investments in businesses have now been made. SEn will provide £1.3 million to nine companies matched by £4.2 million from private sector investors. Detailed performance reports on each investment will be made on a quarterly basis. Individual fund managers are responsible for managing the funds invested and for identifying other investment opportunities. Any profits made from investments will be ploughed back into the Fund for reinvestment.

3.19 The auditors reported that the alleged failure of SEn to claim EU funding to which it may be entitled is likely to refer to the 2002-2006 Risk Capital Programme of the ERDF, which allocated £32 million to those geographic areas of Scotland within which SEn operates. SEn applied for £25 million of this allocation in April 2003, based on its assessment of the maximum that could be claimed given current regulations and the matched funding available. SEn has recently advised that the EU has now confirmed that this application has been successful and SEn expects to receive the funds before the end of 2003. SEn informed the auditors that it could not apply for this funding before April 2003 because of the need to carry out checks on prospective private sector partners which SEn could only have commenced once they had registered with the project. The auditor concluded that the alleged failure of SEn to apply for £32 million EU funding is unfounded.

Intermediary Technology Institutes

3.20 Intermediary Technology Institutes (ITI) are intended to bridge the gap between research carried out by academic research institutes and company led research and development in new emerging markets. Their function will be to identify and commission pre-competitive research. Media concerns focussed on SEn's alleged failure to apply for EU funding to which it may have been entitled and the high risk of project slippage.

3.21 The SEn Board gave formal approval for the further development of the project in March 2002. In particular, SEn was to consider in greater detail factors such as the robustness of the proposed financial model, intellectual property issues, locations and economic impacts.

3.22 The first three ITIs will form part of a holding company limited by guarantee. SEn will appoint the chair and chief executive officers. Although for the foreseeable future SEn will provide the majority of funding for ITIs, it intends there will be an arms-length relationship, with control being exercised by SEn through the approval of strategic and operating plans.

3.23 In October 2002, the SEn Board approved a start-up budget of £3.9 million for the venture with a further commitment of £12.7 million for 2003/04 operations. SEn has already spent £2.1 million on feasibility and development work. SEn informed the auditors that it had not applied for EU funding for this phase of the project as the nature of the start-up costs make it ineligible for assistance. SEn advised that ERDF funding on set-up costs could only be claimed if the ITIs built new premises. SEn is unlikely to pursue this option given the comparatively small scale of the operations at each site (approximately 15 staff). Its business case favours leased premises which would not be eligible for EU assistance.

3.24 SEn considers ITIs to be a long-term project which will be slow to generate income from membership fees from participating companies. SEn, therefore, expects to provide in the region of £450 million core funding over the next 12 years. It will also apply for funding from the Department of Trade and Industry, ERDF and various European research programmes as individual research programmes are commissioned. In the long term, SEn hopes that revenue will be provided from license fees from successful research. Even then, it still expects to be providing core funding 20 years from now.

3.25 The auditors identified that a number of stages in the project were slightly behind schedule, albeit progress has recently been made by the appointment of the key posts of the chair and the chief executive officers of each of the three ITI's. SEn still expects to achieve its target of having the first piece of research commissioned by the end of 2003.

Other EU funding issues

3.26 Although not directly related to major projects, the auditors also referred to an associated area of concern regarding SEn's application for EU funding. In particular, the auditors noted that SEn prepared a report in September 2002 which appraised its corporate management team of the outcome of an internal review of the SEn Network's performance in accessing European funding. The report aimed to highlight some of the issues around EU applications and to identify how the organisation could strengthen its processes.

3.27 The report clearly recognised the political drive for, and the national importance of, securing and fully utilising available EU funding. It found that the SEn Network's past performance in accessing EU funding had been relatively good but that the Network had potentially missed funding opportunities. The report concluded that there is scope for SEn to improve its performance and made a series of recommendations to ensure that all funding opportunities are fully exploited.

3.28 The report indicated that, during 2001/02, SEn did not appear to have considered the scope for EU funding in respect of the financing of 13 projects with a total SEn contribution of £20 million. The report assessed that these projects were technically eligible for EU support and that, accordingly, SEn could possibly have secured EU funding of some £8 million. The report identified that SEn had not taken advantage of these potential funding opportunities because of:

- Perception in the Network that the amounts of EU funding potentially available for some projects in any given year are proportionately too small to justify the bureaucracy to submit and manage applications

- Difficulties associated with pursuing national policies within a regional Objective 2 structure (which can result in up to 23 applications being required for one Network project, leading to a complex management and administrative process)

- The need for a fast response to events, coupled with a slow, inflexible and bureaucratic structural funds decision-making process.

3.29 In response to the auditors' enquiries, SEn reviewed further the projects included within the September 2002 report. It concluded that, although not well documented at the time, in most cases the EU funding opportunity was considered and dismissed either because an application could not be justified, or because it was impractical to submit an application for reasons of timing or disproportionate administration. SEn also pointed out that what is being referred to is a potential, rather than necessarily an actual loss of funding, as an application for funding may not be approved, or funding may have been fully allocated. Also, in SEn's view, any failure by it to submit an application may not necessarily result in a loss to the nation as it could result in another agency within Scotland being able to apply for EU funding which would otherwise be fully allocated.

3.30 The auditors consider that it is to SEn's credit that it has reviewed its processes for securing EU funding, and that it has taken action to secure improvements in this area. Nevertheless, the auditors concluded that it is a matter of concern that SEn did not apply for EU funding of the magnitude identified in the September 2002 report.

Part 4: Use of consultants

Issue

4.1 Media reports expressed concern about the level of SEn's expenditure on consultants and whether this represented an effective use of public money. In separate correspondence to me from an MSP, concern was also expressed in relation to aspects of contracts awarded under the Premier Advisor project. The auditors examined:

- Expenditure on consultants
- SEn's classification of expenditure on consultants in its financial ledger
- The process for engaging consultants and controlling expenditure
- Particular concerns relating to the financial standing of the Premier Advisor project.

Audit findings

Background

4.2 Under the Enterprise and New Towns (Scotland) Act 1991, SEn is responsible for assisting and encouraging the economic development of Scotland. This responsibility is addressed through the three themes and 12 priorities set out in *'A Smart, Successful Scotland'.* In order to deliver against these key priorities, SEn provides a mixture of direct financial assistance and advice through a series of strategic and operational relationships with a wide variety of public and private organisations, both within Scotland and in the wider global economy.

4.3 Over recent years, SEn has also undertaken a comprehensive review of the way in which it conducts its own business. SEn estimates the Business Transformation project will result in a reduction in the number of staff employed in the Network leading to significant cost savings and productivity improvements totalling around £200 million by 2006. The aim of the project is to transform SEn's internal systems and working methods in order to ensure that:

- Every area of SEn's activities is effective, efficient and customer focussed
- Access to all services is improved through e-business
- SEn is transformed into the world's leading e-enabled economic development agency.

4.4 SEn considers that the Business Transformation project is wide ranging, pioneering and highly complex and, as such, makes extensive use of consultants who have specific expertise in this area. Since 1998, SEn has defined a consultant as a specialist entity which provides professional information, advice opinion, assessment, evaluation, observation and/or expertise to assist the development of projects, programmes and initiatives. Consultants differ from 'contractors' who SEn define as being entities that *deliver* projects, programmes and initiatives. SEn considers that, due to the scope and mix of some of the activities undertaken, it is often difficult to have a clear distinction between consultants and contractors. In its view, however, it takes a prudent line in relation to the categorisation of consultancy and contractor expenditure which results in a more comprehensive range of activities being incorporated as 'consultancy', including, for example, professional fees.

4.5 SEn normally commission consultants and contractors either because there is a lack of in-house expertise in the area under consideration, or because insufficient in-house staff resources are available with the expertise necessary to allow projects, programmes and initiatives to be developed and delivered timeously. The SEn Network considers itself to be an enabling organisation working in partnership with others. Since its inception, therefore, it has taken the view that the private sector would be used, wherever possible, to deliver the Network's services where this represents value for money.

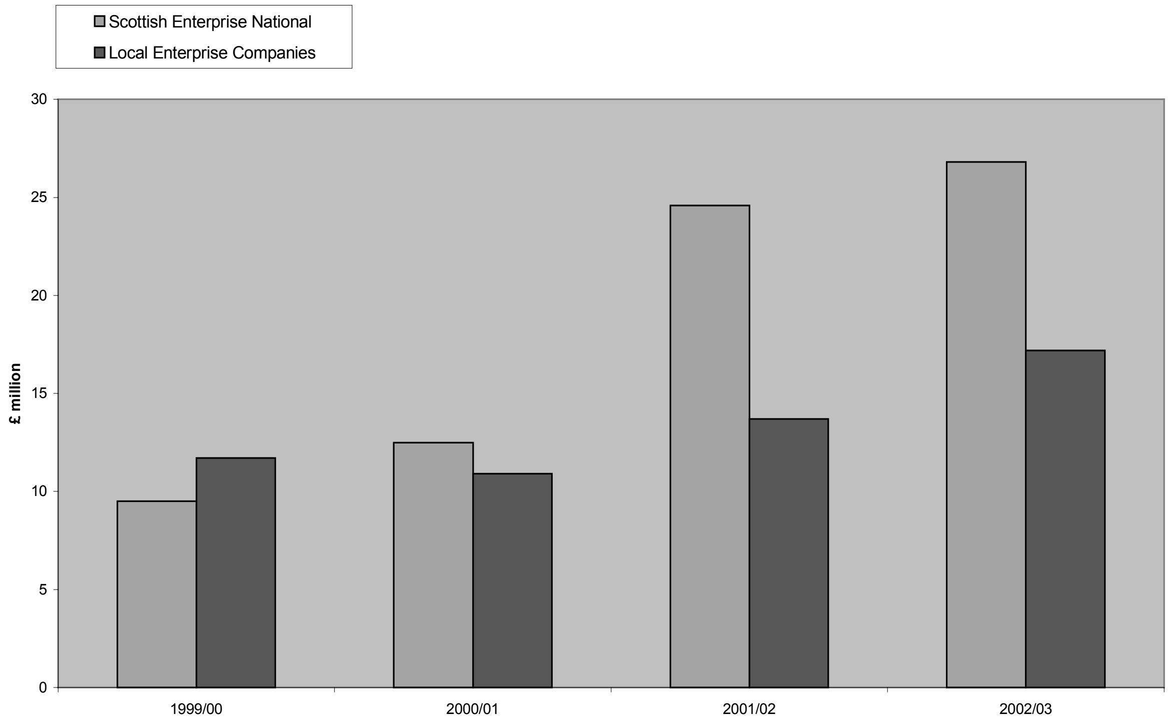
4.6 Under current UK law there is no requirement to disclose expenditure on consultants in an organisation's financial statements. Government agencies are not required to compile routine returns of expenditure on consultants. Consequently, there is no standard definition of a 'consultant'. SEn considers this could lead to inconsistencies in the way in which public sector bodies define consultants, leading to difficulties in comparing expenditure levels on a like-by-like basis.

Levels of consultancy expenditure and the appropriateness of expenditure classification

4.7 The auditors found that the SEn Network's expenditure on <u>consultants</u> increased significantly over recent years, rising from £21.2m in 1999/00 to £43.7m in 2002/03 (a 106% increase). During 2002/03, SEN spent £27.1 million on consultants, representing a 185% increase on 1999/2000 levels. Most of this increase is due to expenditure on consultants associated with the Business Transformation project. LECs spent £16.6 million on consultants in 2002/03, representing a 42% increase on 1999/2000 levels (Exhibit 6).

Exhibit 6

Scottish Enterprise's expenditure on consultants



Source: Audit Scotland

4.8 The auditors found that the SEn Network's expenditure on contractors during 2002/03 totalled £63.8 million. SEN spent £42.5 million on contractors, while LECs spent £21.3 million. Taken together, the SEn Network's combined expenditure of £107.5 million in 2002/03 on consultants and contractors represents:

- 21% of Network management and operating expenditure
- 134% of the Network salary bill
- Approximately 800,000 days per annum, or 3,700 full time equivalent staff, based on the 'in-house' daily cost per employee
- Approximately 215,000 consultant/contractor days per annum, or 1,000 consultants/contractors[4] engaged full time on SEn operations based on an average consultant/contractor cost of £500 per day.

[4] By way of comparison, as at 31 March 2003, the SEn Network employed 2,790 staff, including 1,170 Careers Scotland staff who became SEn employees on or after 1 April 2002.

4.9 The auditors also found that, following a detailed internal review after the 31 March 2003 year-end, SEn reclassified £6.2 million of consultant expenditure more appropriately as contractor expenditure. The effect of this reclassification was to reduce, by around 12%, the previously reported expenditure on consultants[5]. SEn was required to undertake this reclassification because of staff difficulties in interpreting the guidance on the definitions to be applied, and to provide a more accurate analysis of the expenditure being reported. SEn issued revised guidance in April 2003.

Monitoring and control of consultant expenditure

4.10 The auditors found that between June 1999 and April 2003 management information on consultant/contractor spend was not routinely provided to either SEn's Board, or to senior management. SEn considers that such expenditure is more appropriately monitored and controlled as part of the reporting of expenditure at project and/or programme level. Given the increase in consultancy expenditure since 1999/2000 and its significance to SEn's operations, the auditors considered that it is reasonable to expect that consultancy expenditure be regularly reported to and monitored by SEn's Board and senior management.

4.11 SEn told the auditors that, between June 1997 and June 1999, the SEn Board was provided with information on levels of consultancy spend on a six-monthly basis. As these reports contained highly aggregated information, and because the organisation manages its activity at a project and/or programme level, the Board felt that the usefulness of the reports was limited. The Board requested that no further reports be submitted.

4.12 SEn also told the auditors that, as part of its discussions with ETLLD on its budget for 2003/04, it prepared figures on aggregate Network consultancy expenditure for the period 1999/00 to the first six months of 2002/03. SEn's corporate management team has now requested regular updates on consultancy expenditure across the Network. The first report was submitted to the corporate management team in April 2003. SEn has also now undertaken to review how information on consultancy expenditure could best be presented to the Board in future.

Review of consultancy contracts

4.13 The auditors also reviewed a sample of 10 consultancy contracts administered by SEN to determine whether procedures for the appointment of consultants and contract monitoring met SEn's internal guidance and accepted best practice. The sampled contract values ranged from £40,000 to over £10 million. The overall value of the contracts examined was £16.9 million, on which SEn made payments of £7.9 million during 2002/03. The auditors restricted their sample of contracts to those administered by SEN in view of the relative scale of expenditure, and because a recent internal audit of consultancy

[5] The expenditure figures in paragraphs 4.7 and 4.8 reflect the position after reclassification

contracts administered by LECs had not identified any serious shortcomings in procedures. The sample included the main consultancy contract for the Business Transformation project.

Main contract for the Business Transformation project

4.14 SEn's tender documentation for the main consultancy contract for the Business Transformation project required tenderers to specify the functions of named individuals who would work on the contract, the duration of their involvement and their cost. The tender documents set out that SEn would 'ideally' let the contract on a fixed term basis although it acknowledged that this would not be feasible initially. The contract was to comprise two main functions, 'transformation partner' and 'subject matter specialists'. SEn was to assess the tenders received using a points system, with 65% of the total points being attributed to quality factors and 35% to cost.

4.15 SEn concluded that the two tenders submitted satisfied the quality criteria. The main differentiating factor between the two tenders was, therefore, cost. The first tenderer estimated it would spend 9,402 days on the contract and costed its involvement at £18.5 million based on a 5% discount to its standard fee rates. The second tenderer estimated it would spend approximately 2,000 days on the contract, indicated it would discount its standard fee rates by 35% but did not provide an overall cost. As part of their examination, the auditors costed the second tender at £2.7 million on this basis. The second tenderer's daily charge rates were significantly cheaper than those of the first tenderer as a result of the greater discount offered.

4.16 Because there was also a large difference in the number of days anticipated to be spent on the project, SEn were keen to ensure that the second tenderer had a full understanding of the proposed methodology and approach to the work to be undertaken. It therefore held a series of meetings with the second tenderer to clarify its requirements. SEn did not consider a similar meeting with the first tenderer was necessary. The first tenderer had been involved in an earlier phase of the Business Transformation project and was considered to have a clearer understanding of what was expected of them.

4.17 Following the meetings between the second tenderer and SEn, the second tenderer's forecast of the time to be spent on the contract was increased to 3,674 days. SEn also undertook a sensitivity analysis of the 'transformation partner' element of the second tenderer's bid and compared this with the 'transformation partner' element of the first tenderer's bid. SEn calculated a 'best case' cost of the 'transformation partner' element of the second tenderer's bid by multiplying the revised number of days estimated it would provide on this element of the project by the daily rates quoted. SEn also calculated a 'most likely' and 'worse case' cost of the 'transformation partner' element of the second tenderer's bid by further increasing the estimated number of days to be spent on the contract by, respectively, 28% and 82%. This resulted in costs for the 'transformation partner' element of the second tender ranging from £3.6 million to £6.5 million. On the basis of this work and the assessment of quality factors, the SEn Tender Board accepted the second tenderers' bid on a 'time and materials' basis.

4.18 The auditor had a number of concerns relating to the process for awarding the contract:

- The auditors consider that because the two tenders were submitted on different bases, their financial comparison was restricted to the 'transformation partner' element of the project. The comparison took no account of the second tenderer's original estimate of the number days to be spent on the project

- Although SEn intended to implement the fixed price arrangement in due course for all or some of the project, the contract proceeded on a 'time and materials' basis for its duration

- To date, SEn has paid £10.8 million under the contract with the final projected value being £11.9 million. The contract is, therefore, significantly cheaper than that contained in the unsuccessful tender. Despite this, the auditor could not conclude that SEn achieved the most economically advantageous deal because of the different bases on which the two tenders were evaluated. This problem is compounded because, shortly after the second tenderer's bid was accepted, SEn refined and developed the scope of the proposed contract to an extent that it altered significantly from that indicated in the initial tender documents. This renders any comparison with the unsuccessful tenderer impossible. In addition, had other potential tenderers been aware of the extent of SEn's flexibility over the scope of the contract, it may have received more economically advantageous bids

- The difference between the value of both tenders and the fact that SEn has now made payments to the successful contractor which are substantially in excess of that calculated in the original second tender, casts significant doubts as to whether SEn and the successful contractor were fully aware of the scope and extent of the work required.

- SEn awarded the contract on the basis that an agreed number of its staff would work on the project. Due to competing work pressures, SEn was unable to release all 100 staff, as originally intended. This resulted in additional consultancy support being required

- Given the large scale and nature of the project, the decision to award the contract on a 'time and materials' basis may not have allowed for appropriate risk-sharing, nor provided sufficient incentive to the successful contractor to limit its input to the project.

4.19 SEn, however, considers that based on its comparison of consultancy rates contained in both tenders received, the second tenderer was the most cost-effective solution and that it achieved value for money through the process adopted. It takes the view that, because Business Transformation was a complex and developing project, awarding the contract on an initial time and materials basis was the most appropriate way of taking it forward. The tender brief clearly stated that bids were to be invited on a time and materials basis. All those submitting a tender were aware of this and would have pitched their consultancy rates accordingly.

4.20 SEn also takes the view that, because of the evolving nature of the Business Transformation project, the detailed involvement of its consultants inevitably still had to be worked out in discussion with the transformation partner who would emerge from the tender process. SEn maintains it was fully aware of the effect of the proposed changes to the scope of the contract. It was unable to release staff to work on the project as originally intended, due to the significant staff reductions which were an intended outcome of the Business Transformation project.

Other areas of concern

4.21 The auditor also identified a number of other areas of concern regarding SEN's management of consultancy contracts.

Absence of contract documentation

4.22 The absence of signed contract documentation can present problems to an organisation in terms of enforcing contract compliance and resolving contractual disputes. The auditors found that:

- SEn signed the main consultancy contract for the Business Transformation project in January 2003. This was some 18 months after work commenced and only two months before its originally scheduled completion date. By this stage, SEn had made payments of some £9 million under the contract. SEn accepts that the process of agreeing and signing the contract should have been accelerated, but considers that both parties had a clear understanding of their obligations. From the outset, the contractor had fully accepted the principal conditions contained in, and delivered the outputs required by, the draft contract

- SEn could not produce a copy of the signed contract in respect of a contract valued at £4.7 million

- SEn could not produce contract documentation for two contracts on which expenditure to date totals £435,000 and £137,000 respectively. In the second instance, SEn told the auditors that a draft contract has now been prepared and has been issued to the contractor for their consideration.

Failure to expose to competition

4.23 In three instances out of the 10 contracts sampled, SEn could not demonstrate to the auditors that it had formally considered and justified its decision to award contracts (valued at £23,000 plus £95,000 call-off addition, £232,000 and £435,000 respectively) without exposure to competition. Under SEn's tendering procedures, these contracts would normally fall to be exposed to competition. SEn does, however, permit single tender action in a number of specific circumstances, for example when there is only one supplier, or where it would be impractical to let work additional to an existing contract on a competitive basis. SEn maintains that, in two of the three cases cited, the decision to award the work without competition was justified, but accepts that decisions taken prior to the time of contract award were not adequately documented on project files.

Contract approval

4.24 In one of the sampled cases not subjected to competition, the auditors concluded that SEn appeared to have split a project for the purchase of new business software into a number of separate contracts (acquisition, help-desk support, and software assessment), thereby avoiding the need for a higher level authorisation for the project. SEn does not agree with the auditors' view but accepts there is a need for greater clarity within its contract planning and approval processes.

Extensions to contracts

4.25 The auditors found that, out of the ten contracts sampled, SEn extended one contract initially valued at £1.2 million without it being further exposed to competition. Due to extensions to the scope of the project, SEn eventually paid the consultants £4.7 million through a series of approved variation orders for additional work. The auditors concluded that such a scale of extension goes against accepted best practice and could expose SEn to charges of failing to competitively tender work. SEn told the auditors, however, that it always considered exposing further work to competition, but inevitably awarded a proportion of the evolving elements of a contract to the original contractor because of their knowledge and experience of the project. As part of the Business Transformation project, SEn is developing improved contract tendering, procurement and management arrangements which it considers will address the auditors' concerns.

Payment in advance of receipt of goods or services

4.26 Following previous concerns expressed by the external auditors during the audit of SEn's financial statements, SEn reviewed all payments over £100,000 and a sample of other payments to public sector bodies across all areas of activities made in March 2003 to determine whether sums may have been paid before a contractual commitment existed or before payments were due. The review identified payments totalling £1.2 million which had been made in advance of receipt of goods or services. The auditor considers that, although the sample was biased towards high risk transactions, there is a strong probability that there will be other instances, in-year and below the investigation threshold, where payment has been made in advance of receipt of goods or services.

Compliance with EU regulations and Scottish Executive requirements

4.27 The auditors identified a number of instances where SEn had not complied with aspects of EU procurement regulations in relation to the advertising of tenders:

- In one case, SEn did not advertise a contract in the Official Journal of the European Communities (OJEC) on the grounds that, at an estimated contract value of £65,000, it did not exceed the financial threshold at which the EU requires contracts to be advertised. Over a period of time, as the project developed and evolved, SEn extended the contract to an aggregate value of £435,000. The auditors concluded that had the contract value been estimated with greater accuracy from the outset, SEn would have been required to advertise it in OJEC

- SEn did not advertise in OJEC two other contracts whose values were above the EU advertising threshold. SEn told the auditors that, at the time of tendering, it obtained informal legal advice to the effect that advertising in OJEC was not required. Despite this, there was no record of the informal legal advice on file. SEn obtained formal legal advice, confirming the earlier view, after the auditors raised their concerns

- SEn did not comply with EU requirements to advertise the successful tenderer in OJEC in respect of two contracts.

4.28 The auditors also noted that, contrary to the requirements of the then extant Management Statement between ETLLD and SEn, SEn did not seek prior approval for accepting or extending the main consultancy contract for the Business Transformation project and another contract valued at £4.7 million. Subsequent to the auditors' investigations, ETLLD gave retrospective approval and intimated that it was aware of the situation when these contracts were awarded.

Financial assessments and tender evaluations

4.29 SEn's internal procedures require it to undertake a financial assessment of a proposed contractor to ensure that it has the financial resources to complete the contract. The auditors found that SEn had undertaken the financial assessment in only one of the 10 contracts sampled.

4.30 SEn does not use a standard 'scoring sheet' for the purpose of evaluating and comparing tenders. The auditors found that, where scoresheets were used, they varied in design and quality. In one contract, with a value of £230,000, the score sheet contained no reference to the tender value although, in this instance, the successful tenderer was the lowest bidder. The standard of completion of scoresheets was also variable with scoring of individual elements not always clearly differentiating between tenderers. In some cases, the auditors concluded there was also a lack of clarity and documentation to support the decision to appoint a particular tenderer.

Contract monitoring and post implementation review

4.31 The auditors found that there was a wide variation in practice in how SEn monitors and controls contract payments. For the larger contracts, SEn uses ad hoc spreadsheets to monitor cost against progress and approved variation orders. The auditors noted, however, that in contracts valued at up to

£25,000, the same member of SEn staff with responsibility for authorising and controlling contract expenditure can also approve contract variations. The auditors consider this gives rise to the risk of contract overspends being regularised by variation orders, and that SEn should introduce greater segregation of duties in this area.

4.32 SEn's guidance requires all contracts over £100,000 to be subjected to a post-implementation review in order to establish whether the anticipated benefits of the contract had been achieved and to evaluate the performance of the contractor/consultant. The auditors found that SEn did not have a system to prompt when such a review should have been undertaken. In the one contract examined by the auditor where a review had been undertaken, the review focussed exclusively on the project and did not comment on the performance of the contractor.

4.33 SEn's procedures also require all consultancy contracts to be notified to its Knowledge Exchange department to enable other consultancy procurers to be aware of previous work carried out in that area or by a particular consultant. The auditors established that these procedures are not being followed.

Standard of documentation

4.34 An increasing amount of SEn's business is now being administered in an electronic manner, with a consequential reduced reliance on paper files. The auditors' review of 10 contracts found that contract files did not always record in a structured manner all the key judgements and decisions made. SEn provides advice to staff on the maintenance of contract files via its in-house intranet, but it appears this is not always followed. Project managers were usually able to explain to the auditors the background to decisions made. The auditors consider, however, there is a need for a clearer audit trail to explain how key decisions and judgements are arrived at.

4.35 SEn accepts its current project management procedures require to be improved. It is implementing a 19-point action plan to address the areas of concern raised by the auditors.

Premier Advisor programme

4.36 The Premier Advisor programme is designed to train individuals who will improve SEn's service delivery through providing enhanced business advice. Concerns were expressed about a number of aspects of the financial management of the programme. In some cases the substance of the concerns had already been investigated by SEn's internal auditors as part of their planned work, and the external auditors relied on internal audit's findings.

Concern 1: The main contractor for the programme has had the contract since 2000, has been paid around £750,000 per annum in direct fees, and the contract is renewed annually without exposure to competition.

4.37 The auditors found that SEn awarded the contract to administer the programme through a competitive tendering exercise. The contractor was the lowest of three tenders assessed, tenders being based on a two-year engagement. For operational reasons, SEn initially let the contract only for the first year of the project, valued at £230,000. SEn was satisfied with the contractor's performance and awarded a further one-year contract without competition for £220,000. SEn made further payments to the contractor totalling £112,000 for administrative services not provided for in the contracts. Payments to the contractor to date on the Premier Advisor programme total £641,000.

Concern 2: The entire programme has cost the SEn Network around £3 million over 2 years. This implies a cost per trainee processed of around £20,000 to £25,000.

4.38 SEn's total gross expenditure on the programme to date is £2.9 million, with £262,000 having been received in EU grant. SEn now expects the project to cost £3.1 million of which £760,000 will be met from EU funds. To date, 360 advisors have been trained at a cost of £8,000 each. The final number of trained advisors is expected to be around 520 at a cost of £6,020 each.

Concern 3: The programme had exceeded its 2002/03 budget by January 2003. Accordingly payments due to contractors of £250,000 for the period October 2002 to December 2002 were withheld until July 2003.

4.39 The auditors found that invoices to the value of £167,000, submitted for payment in January 2003 were not paid until SEn Board approval was provided in June 2003. SEn did not pay the invoices when they were received because the Premier Advisor programme had exceeded its original £2.1 million budget. The budget was exceeded due the original approved budget being net of EU funding and because of additional cost pressures arising from the extension of the programme to overseas staff. SEn told the auditors that the programme ran into funding difficulties due to delays in applying for EU funds additional to the £262,000 received to date, and in identifying additional costs requiring Board approval.

Concern 4: Former employees are being granted consultancy contracts on favoured terms.

4.40 SEn internal audit concluded that, with the exception of mentors who were appointed on a fixed cost basis following testing at an assessment centre, SEn appointed all contractors employed on the Premier Advisor programme on the basis of competitive tenders. Internal audit checked individuals employed by all contractors and those employed as training mentors against SEn personnel records. They identified two individuals who were previously employed by LECs, having left SEn employment in 1999 and 2000 respectively. Both these individuals won their contracts under the Premier Advisor programme following a competitive tendering process. They have received payments under their contracts totalling £140,000 and £81,000. The internal audit investigation identified no breach of SEn contracting rules in this regard.

Concern 5: Six consultants were flown to Hong Kong for a week, to train three SEn staff in the Hong Kong office. In addition, the consultants spent a week on this training when they would normally only spend a couple of days.

4.41 SEn internal audit enquiries established that two trainers on the Premier Advisor programme and other training programmes visited Japan to train four members of the SEn office located there. The total time spent on Premier Advisor activities was five days. During the same week, four other SEn staff not involved in the Premier Advisor project visited Japan as part of their normal duties.

Part 5: Customer relations staffing

Issue

5.1 Media coverage included concerns about the high number of SEn staff employed in customer relations. Initial reports suggested 92 staff were employed in SEn's Public Relations department although subsequent reports implied that the organisation employed 62 staff in this area. The auditors sought, therefore, to determine the actual number of SEn staff employed in customer relations, and their deployment.

Audit findings

5.2 The auditors confirmed that the overall establishment for SEn's Customer Relations department is 92 staff, excluding six staff who provide services direct to Careers Scotland. The establishment comprises a core staff complement of 62. In addition, SEn had provisionally identified the need for a further 30 posts as part of its Business Transformation project to service the new Network-wide customer management operation. SEn considered that these new posts would enable it to respond more quickly to customer inquiries, and to provide relevant information, products and services which more closely match customers' needs. SEn expects this will result in productivity savings by freeing-up other staff to account-manage customers.

5.3 Of the 92 staffing complement, 71 staff are in post with 21 posts vacant. The Business Transformation projects accounts for 19 of the unfilled posts. The SEn Board has yet to give formal approval to fill these vacancies. SEn is now reconsidering whether to fill these posts, in light of changing operational need, including the further development of its Customer Relations Management project[6].

5.4 The auditors concluded that SEn's Customer Relations department has a wider remit than the 'press and public relations activities' which may be inferred from its title. The auditor's analysis of the 71 staff in post shows that they are employed in a range of functions, some of which directly involve the delivery of services to business customers:

- A senior director heads the Customer Relations department, assisted by an executive assistant. The senior director's responsibilities include the overall management of the department and the delivery of the SEn Network's Customer Relations Strategy

[6] SEn's Customer Relations Management project involves the development of a computer based system to manage relationships with, and track enquiries from, its customers. SEn considers the project may result in fewer customer management staff than originally envisaged. The project is currently with the SEn Board for approval.

- 10 staff are employed in a corporate management team role, providing administrative support to the SEn chairman and Board, the chief executive, LEC chairs and the rest of the Customer Relations department

- Six staff are directly responsible for building relationships with key customers and stakeholders. This includes a parliamentary unit to manage the provision of evidence to Parliamentary Committees and responses to elected members' enquiries

- Nine staff comprise the Customer Experience Team, with responsibilities which include manning of the business customer helpline and associated customer intelligence activities

- 25 staff comprise a Network Marketing Team. This team is responsible for providing services directly to LECs and promoting projects and services to customers. The promotion of Scotland overseas also falls within its remit

- 12 staff comprise the Corporate Communications Team, which is responsible for internal, local and national corporate publications. Of these 12 staff, six work in SEn's press office liasing with the media

- Seven staff have been recently appointed to an Operations Team to develop the new Network-wide customer management operation, including support for SEn On-line and SEn's customer segmentation strategy.

5.5 In addition to these staff, the auditors also identified three external PR firms which provide PR services for LECs and locally managed projects. SEn informed the auditors that the contracts for these services were awarded on a competitive basis in March 2003. This resulted in the number of contracts used by the SEn Network for PR purposes reducing from 16 to three. SEn told the auditors that, as a result, it anticipates that the quality of its PR service will improve and that cost savings of over £300,000 per annum will result.

Appendix 1

Scottish Enterprise reported performance against targets 2002/03

	Target 2002/03	Outturn 2002/03
Growing Businesses		
Business start-ups assisted	8,000	8,772
- high growth	175	219
- women	3,040	3,182
- residents from disadvantaged areas	850	1,034
Account managed businesses showing improved innovation performance	500	635
Organisations assisted to market and transact on-line	1,425	2,179
Organisations assisted to launch new products/services and implement processes	520	654
Academic and company spin-outs assisted	50	46
Businesses assisted in achieving recognised environmental standards	50	55
Global connections		
Organisations in key industries assisted to operate internationally, at least 50 of which will involve deeper forms of internationalism (e.g. joint ventures, strategic alliances)	550	746
Planned new jobs through Foreign Direct Investment of a research, design and development nature (out of a total target of 6,000 jobs from Foreign Direct Investment)	900	918
Broadband hub in Scotland providing high quality telecom services at competitive prices	Achieve	Achieved
Accommodation provided for key industries (sq.m)	80,000	116,149
New international business transport links established as a result of SEn influence	3	5
Highly skilled individuals retained or attracted to Scotland (pilot)	100	158
Skills and learning		
Adults in work based training and development activities	8,200	10,647
- adult participants from disadvantaged areas	2,600	3,653
Adults still in employment 3 months after leaving training	2,800	5,658
Participants in Modern Apprenticeships	20,000	25,387
Modern Apprenticeships achieved	5,000	6,404
Low paid staff with low level qualifications undertaking core skills development	2,200	3,199
Investor in People first time recognitions and reviews	800	906

Source: Scottish Enterprise Annual Report 2002/03

Scottish Enterprise
Special audit examination

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