

Highlands & Islands Enterprise Network Accounts 2002-2003

ENTERPRISE AND NEW TOWNS (SCOTLAND) ACT 1990

Accounts, of Highlands & Islands Enterprise prepared pursuant to section 30(1) of the Enterprise and New Towns (Scotland) Act 1990, for the year ended 31 March 2003 together with the Independent Auditor's Report.

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Foreword

Statutory Background and Principal Activities

Highlands and Islands Enterprise (HIE) was established in 1991 in accordance with the provisions of the Enterprise and New Towns (Scotland) Act 1990 for the purpose of preparing, concerting, promoting, assisting and undertaking measures for the economic and social development of the Highlands and Islands, maintaining and enhancing skills and capacities relevant to employment, assisting people to establish themselves as self-employed and furthering improvement of the environment in the Highlands and Islands.

Results

The results for the year to 31 March 2003 are contained in the attached accounts which have been prepared in accordance with section 30(1) of the Enterprise and New Towns (Scotland) Act 1990 and are in the form directed by Scottish Ministers.

The annual report provides more detailed information regarding the results for the year. A review of key performance targets is included in the annual report.

With effect from 1 April 2002 responsibility for the management and operation of Careers Scotland in the Highlands and Islands Enterprise area was assumed by the Chief Executive of Highlands & Islands Enterprise.

The results for the year to 31 March 2003 include income and expenditure relating to Careers Scotland.

Sources of Finance

Highlands and Islands Enterprise is mainly financed by Scottish Ministers through the Scottish Executive Enterprise & Lifelong Learning Department. In addition, it has receipts in the form of rents, interest, loan repayments and proceeds received from the sale of assets. The funding provision and payments for the year ended 31 March 2003 were:

	Provision £m	Actual £m
Funding		
Grant-in-aid*	79.7	78.8
Receipts	<u>20.0</u>	<u>23.8</u>
	<u>99.7</u>	<u>102.6</u>
Payments		
Growing Businesses	22.3	22.4
Global Connections	29.9	28.9
Skills and Learning	17.3	18.6
Strengthening Communities	5.7	8.2
Administration Costs	<u>24.5</u>	<u>24.5</u>
	<u>99.7</u>	<u>102.6</u>

*Grant-in-aid provision drawn down in 2002-03 totalled £78.8m. By 31/03/03 £75.0m had been drawn down and a further £3.8m was drawn down after this point relating to expenditure incurred in 2002-03. Under normal accounting practice this was accrued into 2002-03 to match the expenditure incurred. Subject to Scottish Ministerial consent, the net balance of the 2002-03 provision of Grant-in-Aid of £0.9 million, will be carried forward to the 2003-04 financial year.

The 2002-03 financial year represented a significant one for funding with income exceeding the £100 million level for the first time due to increased levels of receipts from property and equity sales.

Sources of Finance (continued)	Analysis of payments	2002/03 (£m)	2001/02 (£m)
	Payments to Local Enterprise Companies:		
	Argyll & the Islands Enterprise	7.9	7.0
	Caithness & Sutherland Enterprise	4.6	3.9
	Inverness & Nairn Enterprise	5.3	4.6
	Lochaber Enterprise	4.5	2.4
	Moray Badenoch & Strathspey Enterprise	5.5	6.1
	Orkney Enterprise	2.4	2.2
	Ross & Cromarty Enterprise	5.6	5.8
	Shetland Enterprise	3.9	2.7
	Skye & Lochalsh Enterprise	2.4	2.1
	Western Isles Enterprise	<u>5.1</u>	<u>5.4</u>
		47.2	42.2
	Payments made on behalf of Local Enterprise Companies	23.2	27.7
	Highlands & Islands Enterprise	<u>32.2</u>	<u>25.8</u>
		<u>102.6</u>	<u>95.7</u>

The income for 2002/03 increased overall by £6.9 million. This was due to an increase in other receipts and Grant in Aid.

The analysis of the additional income received during 2002/03, compared with 2001/02, is as follows:

	2002/03 (£m)	2001/02 (£m)
Income from Operations	16.7	14.2
Investment Income	5.1	0.9
Associated Investment Income	1.6	0.1
ERDF	<u>0.4</u>	<u>4.9</u>
Total	<u>23.8</u>	<u>20.1</u>

Overall expenditure in the LEC areas has increased, whilst payments on behalf of LECs has decreased, reflecting the earlier strategic decision to devolve more resources and accountability to LECs from the HIE Network.

It should be noted that in making comparisons between financial years, variations arise due to funding arrangements made by HIE to provide additional resources to meet major strategic initiatives in the LECs. This flexibility means that initial funding may vary widely depending on the number and value of projects within these initiatives.

Fixed Assets

During the year, Highlands and Islands Enterprise network spent £13 million on site development and construction of factory buildings.

At 31 March 2003 the net book value of Highlands and Islands Enterprise's tangible fixed assets was £37 million. The net book value of the Network's tangible fixed assets was £37 million. Commercial properties were valued at market value. Loans and share investments amounted to £1 million for Highlands and Islands Enterprise; the Network's investments amounted to £5 million.

European Union

In addition to the funding from grant-in-aid, funds amounting to £4.6 million were received from the European Union in support of the operations of the Highlands and Islands Enterprise network. The Local Enterprise Companies received £0.4 million of the total European Union funding direct and the balance of £4.2 million was received by Highlands and Islands Enterprise.

Payment to Creditors

The HIE Network observes the Government's policy for prompt payment under the Better Payment Practice Code and is committed to paying suppliers within one month of receipt of a valid invoice, where no other contract timetable applies.

During the year ended 31 March 2003 Highlands and Islands Enterprise paid 95 per cent of all invoices received within the terms of this payment policy; the Network paid 97 per cent of all invoices received within the terms of the same payment policy.

Strategic Aims

The HIE Network's stated aim is to enable people living in the Highlands and Islands to realise their full potential. In order to achieve this, the Network pursues four broad strategic objectives: strengthening communities, developing skills, making global connections and growing businesses.

The annual report provides further details of the specific aims and strategy of the Network for 2003/2004.

Board Membership

Dr James Hunter	CBE	Chairman
Mr J R A Cumming	CBE	Chief executive
Mrs M Campbell		
Mrs W Campbell		
Mr A Gray		
Mr J Gray		
Mr H Halcro-Johnston	CBE	(resigned 30 September 2002)
Mr D MacInnes	MBE	
Mr D Ratter		(appointed 1 October 2002)
Mr W Roe		
Mr A Rogers		
Mr G Sword		
Mrs S Torrance		

Corporate Governance

The Board

At 31 March 2003, the board of Highlands and Islands Enterprise comprised ten non-executive members, excluding the chairman, and one executive member who is the chief executive. Board members are appointed by Scottish Ministers and their remuneration is determined by the Scottish Executive Enterprise & Lifelong Learning Department.

The board meets at least eight times a year. The role of the board is the strategic oversight of the Network, ensuring that it is carrying through its statutory remit. The board has specific responsibility for approving the overall strategy and operating plans, ensuring that the executive has thorough arrangements for appraisal, monitoring and evaluation of programmes and seeing that targets are set and met.

As a board member the chief executive also has a pivotal role in assisting the board to develop policies and priorities and in ensuring that they are implemented effectively.

Audit Committee

Highlands and Islands Enterprise has established an audit committee composed of four non-executive members of the board, one of whom acts as its chairman. The chief executive in his role as accountable officer, a representative of the Scottish Executive departmental accountable officer, the director of corporate services, having specific responsibility for finance, and the head of internal audit normally attend the meetings of the committee which are held not less than three times per year.

The Combined Code

While the remuneration and the service contracts of board members are set by the Scottish Executive Enterprise & Lifelong Learning Department, the recommendations of the Combined Code have been applied in so far as they are appropriate to Highlands and Islands Enterprise. Full details of all elements in the remuneration package of each board member are disclosed in note 8 to the accounts.

Conflicts of Interest Procedures

The HIE Network operates strict and comprehensive procedures to deal with potential conflicts of interest. These include the HIE core and each LEC holding, and updating annually, registers of interests covering not only board members/directors but also senior members of staff. These registers are available to any member of the public who wishes to examine them. Interests which must be registered are rigorously defined as: any contractual or financial relationship, or simply position of authority, with outside companies or organisations.

Whenever a board member/director or member of staff has an interest in an application for assistance, he/she is required to declare the interest and thereafter to take no part in the investigation, processing or approval of the case. Such declarations by board members/directors are recorded in the minutes of the appropriate board meetings.

Additional procedures are invoked when a LEC chairman declares an interest (such cases are referred to HIE for processing and decision).

Complaints

The HIE Network has in place a clear policy for dealing with complaints. Where it is not possible to resolve the complaint internally a complainant is entitled under the terms of the Scottish Public Services Ombudsman Act 2002 to have their complaint considered by the Scottish Public Services Ombudsman.

Openness

The HIE Network complies with the Scottish Executive Code of Practice on Access to Information and the Data Protection Act 1998.

Service First

The HIE Network monitors regularly progress in meeting the standards and aspirations embodied in the principles of public service delivery contained in Service First and, if necessary, takes action to ensure that effective performance is maintained or achieved. The HIE Network retains Charter Mark status which was awarded for the third time in 2000.

Statement of Highlands and Islands Enterprise's Responsibilities

Under section 30(1) of the Enterprise and New Towns (Scotland) Act 1990, Highlands and Islands Enterprise is required to prepare a statement of accounts in the form and on the basis determined by Scottish Ministers. The accounts are prepared on an accruals basis and must give a true and fair view of Highlands and Islands Enterprise's state of affairs at the year end and of its income and expenditure and cash flows for the financial year.

In preparing the accounts, Highlands and Islands Enterprise is required to:

- Observe the accounts direction issued by Scottish Ministers, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- Make judgements and estimates on a reasonable basis;
- State whether applicable accounting standards have been followed, and disclose and explain any material departures in the financial statements;
- Prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the entity will continue in operation.

Statement of Chief Executive's Responsibilities

The accountable officer for the Scottish Executive Enterprise & Lifelong Learning Department has designated the chief executive as the accountable officer for Highlands and Islands Enterprise. His relevant responsibilities as accountable officer, including his responsibility for the propriety and regularity of the public finances and for the keeping of proper records, are set out in the Memorandum to Accountable Officers of other Public Bodies issued by Scottish Ministers.

Diversity and Equal Opportunity

The Highlands and Islands Enterprise network is committed to equal opportunities for all individuals dealing with the network, such as employees or potential employees, customers, business partners or other stakeholders. The network aims for inclusiveness in order to create a working culture that seeks, respects, values and harnesses difference and is free of discrimination. These differences include sex, ethnicity, disability, nationality, age, marital status, religion, and sexual orientation.

Employee Involvement and Communication

The Highlands and Islands Enterprise network values the contribution of all employees and encourages a culture of open communication. As an Investor in People employer the network places great emphasis on learning and provides and encourages personal development opportunities.

Employees are kept up to date through formal and informal communication. Regular briefings from the management group on key issues and decisions are available to all employees of the network. Weekly team meetings are encouraged throughout the network and employees have the opportunity to attend quarterly presentations each year on past network performance and future priorities. These meetings also provide employees with the opportunity to raise other issues with the Chief Executive and the senior management team. In addition, new developments are introduced through workshops and presentations to all, or groups of employees. Regular updates, office notices and newsletters are being published on the Intranet.

Formal consultation takes place through the Joint Negotiating Committee (JNC), which involves members of HIE management, local trade union representatives and a full-time official from the Public and Commercial Services Union (PCS) and UNISON. The JNC meets at least five times a year.

Appointment of Auditors

The accounts of Highlands and Islands Enterprise are audited by auditors appointed by the Auditor General for Scotland.

J R A Cumming
Highlands and Islands Enterprise

30 September 2003

Statement on the System of Network Internal Control

- 1 As Accountable Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of Highlands and Islands Enterprise's policies, aims and objectives, set by Scottish Ministers, whilst safeguarding the public funds and assets for which I am personally responsible, in accordance with the responsibilities assigned to me.
- 2 The system of internal control is designed to manage rather than eliminate the risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness.
- 3 The system of internal control is based on an ongoing process designed to identify the principal risks to the achievement of the organisation's policies, aims and objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively and economically. This process has been in place for the year ended 31 March 2003 and up to the date of approval of the annual report and accounts and accords with guidance from the Scottish Executive.
- 4 As Accountable Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. The following processes have been established for the HIE Network:
 - a Management Group which normally meets weekly. This group comprises Directors and Senior Management of the HIE Network. Major executive decisions are taken by myself in consultation with that Group.
 - a Board which normally meets eight times a year. The Board is comprised of a part-time Chairman, 10 non-executive members and myself. The Board is responsible for the overall direction of the organisation within the strategic and funding framework set by Scottish Ministers. It has a general corporate responsibility for:
 - ensuring that Highlands and Islands Enterprise complies with any statutory or administrative requirements for the use of public funds and, in so doing, satisfying itself that Highlands and Islands Enterprise operates within the delegated authorities agreed with the Scottish Executive Enterprise and Lifelong Learning Department;
 - ensuring that high standards of corporate governance are observed at all times;
 - ensuring that its aims and objectives are explained to and understood by staff; and
 - overseeing the delivery of planned results by monitoring performance against agreed corporate objectives, measures and targets on both an in-year and longer-term basis.
 - an Audit Committee which meets not less than three times a year and which reviews the effectiveness of the internal control system. Minutes of the Audit Committee are copied to the full Board.
 - Highlands and Islands Enterprise has had a robust risk management strategy in place since November 2000. This has been implemented across the HIE Network since March 2001 and is continually reviewed to ensure it remains relevant. This strategy highlights that effective risk management is essential to the achievement of the Network objectives. Implementation of this strategy includes:
 - the quarterly assessment of risk by management;
 - the maintenance of organisation-wide risk registers;
 - the maintenance of a strategic risk register;
 - assessment of risk at individual project level;

- gateway reviews for high risk projects;
 - action plans with clear accountability and timescales to address significant risks.
- the Highlands and Islands Enterprise Board are made aware of the key risks for the Network on a quarterly basis.
 - formal project appraisal training has been provided to staff including senior management, project officers and Board Members. This includes detailed training on risk assessment and management.
 - annual corporate governance conference held for senior management and Network Audit Committee members to raise the awareness of governance issues throughout the Network.
 - setting targets to measure financial and other performance.
- 5 Highlands and Islands Enterprise has an Internal Audit and Compliance Team which is independent of any operational group. The Head of Internal Audit and Compliance reports directly to me as Accountable Officer.
- the work of the Internal Audit and Compliance team is informed by an analysis of the risk to which the HIE Network is exposed and annual internal audit plans are based on this analysis. The plan is endorsed by the HIE Audit Committee.
 - the Head of Internal Audit and Compliance provides me with regular reports on internal audit activity and provides me with an annual report which includes the Head of Internal Audit and Compliance's independent opinion on the adequacy and effectiveness of the system of internal control together with recommendations for improvement.
 - the Internal Audit and Compliance team supports the Network's continuous improvement activities through the identification of action points arising from on going audit activity. These actions cover all aspects of the Network's operations.
 - during the last 2 financial years the HIE Network has undergone significant operational change including the opening of a Data Centre in Benbecula. During this transitional phase the Internal Audit and Compliance team have worked with Management to identify areas for improvement and make recommendations on any actions required with respect to the internal control environment.
 - the internal audit plan includes cyclical reviews of the implementation of the HIE Network risk management strategy, this includes ensuring that any risks are adequately defined and actions comply with SMART criteria.
- 6 My review of the effectiveness of the system of internal control is informed by the work of the internal auditors, the audit committee which oversees the work of the Internal Audit and Compliance team, the executive managers within the organisation who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letters and other reports.
- 7 Individual Learning Accounts (ILAs)
- In the 2001/02 Statement of Internal Control Highlands and Islands Enterprise noted that irregularities had arisen in the operation of the ILA programme and that they had undertaken extensive monitoring reviews to validate claims. This exercise is now complete in terms of Highlands and Islands Enterprise's responsibilities under the ILA scheme.

J R A Cumming
Accountable Officer

30 September 2003

Independent Auditor's report

To the members of Highlands and Islands Enterprise, the Scottish Parliament and the Auditor General for Scotland

I have audited the financial statements on pages 11 to 40, which have been prepared under the Enterprise and New Towns (Scotland) Act 1990. The financial statements have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and in accordance with the accounting policies set out on pages 14 to 17.

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice approved by Auditor General for Scotland and for no other purpose, as set out in paragraph 43 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by Audit Scotland, dated July 2001.

Respective responsibilities of Highlands and Islands Enterprise, the Chief Executive and Auditor

As described on page 5 Highlands and Islands Enterprise and the Chief Executive are responsible for the preparation of the financial statements and for ensuring the regularity of expenditure and receipts. Highlands and Islands Enterprise and the Chief Executive are also responsible for the preparation of the Foreword. My responsibilities, as independent auditor, are established by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice approved by the Auditor General for Scotland, and guided by the auditing profession's ethical guidance.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Enterprise and New Towns (Scotland) Act 1990 and directions made thereunder and whether, in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. I also report if, in my opinion, the Highlands and Islands Enterprise Network has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the statement on pages 7 and 8 complies with the Scottish Executive guidance on statements on the system of internal control. I report if, in my opinion, it does not comply with the guidance, or if the statement is misleading or inconsistent with other information I am aware of from my audit. I am not required to consider whether the statement covers all risks and controls, or form an opinion on the effectiveness of the Highlands and Islands Enterprise Network's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Foreword and consider whether it is consistent with the audited financial statements. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinions

I conducted my audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice, which requires compliance with relevant United Kingdom Auditing Standards issued by the Auditing Practices Board.

An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of expenditure and receipts shown in the financial statements. It also includes an assessment of the significant estimates and judgements made by Highlands and Islands Enterprise and the Chief Executive in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Highlands and Islands Enterprise Network's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error, and that, in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinions

Financial statements

In my opinion the financial statements give a true and fair view of the state of affairs of Highlands and Islands Enterprise and the Highlands and Islands Enterprise Network at 31 March 2003 and of the deficit, total recognised gains and losses and cash flows for the year then ended and have been properly prepared in accordance with the Enterprise and New Towns (Scotland) Act 1990 and directions made thereunder.

Regularity

In my opinion, in all material respects the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Robert McFarlane
Regional Director
Audit Scotland
18 George Street
Edinburgh
EH2 2QU

30 September 2003

Network Income and Expenditure Account for the year ended 31 March 2003

	Notes	2003 £000	2002 £000
Income from operating activities	2	16,711	14,251
Expenditure on operating activities	3	(76,197)	(65,065)
Administration and management charges	4	(21,475)	(18,245)
Deficit on operating activities		(80,961)	(69,059)
Share of associate's operating loss		(338)	(110)
Notional interest charge	5	(3,312)	(3,091)
Investment income	6	5,144	906
Share of associate's investment income		1,588	104
Interest payable	7	(3)	(1)
Deficit on ordinary activities before taxation		(77,882)	(71,251)
Taxation	12	(271)	(31)
Deficit on ordinary activities after taxation		(78,153)	(71,282)
Notional interest credit	5	3,312	3,091
Deficit for the year	22	(74,841)	(68,191)

All income and expenditure for each of the two years ended 31 March 2003 arises from continuing activities.

Network Statement of Total Recognised Gains and Losses for the year ended 31 March 2003

	2003 £000	2002 £000
Deficit for the year	(74,841)	(68,191)
Unrealised deficit on revaluation of property	(102)	(120)
Share of unrealised surplus on revaluation of investments by associated undertaking	-	260
Release of share of unrealised reserve in associated undertaking	(997)	-
European Regional Development Funds received during the year	447	4,947
Grant-in-aid received during the year	78,793	75,618
Total recognised gains for the year	3,300	12,514

Network and Highlands & Islands Enterprise Balance Sheets as at 31 March 2003

	Notes	NETWORK		HIE	
		2003 £000	2002 £000	2003 £000	2002 £000
Fixed Assets					
Tangible assets	13	37,084	41,165	36,718	40,538
Investments	14	4,603	5,713	859	1,321
Investment in associate		1,102	1,093	-	-
		<u>42,789</u>	<u>47,971</u>	<u>37,577</u>	<u>41,859</u>
Current Assets					
Stocks	15	27	37	27	37
Debtors	16	18,269	13,540	25,459	22,666
Cash at bank and in hand	17	2,767	1,024	1,539	531
		<u>21,063</u>	<u>14,601</u>	<u>27,025</u>	<u>23,234</u>
Current Liabilities					
Creditors: amounts falling due within one year	18	<u>6,679</u>	<u>7,277</u>	<u>12,474</u>	<u>13,554</u>
Net Current Assets		<u>14,384</u>	<u>7,324</u>	<u>14,551</u>	<u>9,680</u>
Total Assets less Current Liabilities		<u>57,173</u>	<u>55,295</u>	<u>52,128</u>	<u>51,539</u>
Creditors: amounts falling due after more than one year	19	<u>1,537</u>	<u>2,512</u>	<u>1,537</u>	<u>2,512</u>
Net Assets		<u>55,636</u>	<u>52,783</u>	<u>50,591</u>	<u>49,027</u>
Reserves					
Revaluation reserve	22	180	282	180	242
Other reserve	22	36	1,033	-	-
General reserve	22	55,420	51,468	50,411	48,785
		<u>55,636</u>	<u>52,783</u>	<u>50,591</u>	<u>49,027</u>

J R A Cumming
Accountable Officer

30 September 2003

Network Cash Flow Statement for the year ended 31 March 2003

	Notes	2003 £000	2002 £000
Net cash outflow from operating activities	23	(77,466)	(61,699)
Returns on investments and servicing of finance	24	1,252	1,028
Taxation	24	(25)	9
Capital expenditure and financial investment	24	<u>(1,387)</u>	<u>(22,821)</u>
Net cash outflow before financing		(77,626)	(83,483)
Financing	24	<u>79,369</u>	<u>76,377</u>
Increase/(decrease) in cash		<u>1,743</u>	<u>(7,106)</u>
Reconciliation of net cash flow to movement in net funds			
Increase/(decrease) in cash		1,743	(7,106)
Cash outflow from lease financing		-	4
Movement in net funds		<u>1,743</u>	<u>(7,102)</u>
Net funds at 1 April 2002		1,024	8,035
Funds transferred from MBSE		-	91
Net funds at 31 March 2003	25	<u>2,767</u>	<u>1,024</u>

Notes to the Accounts

1. Accounting Policies

Basis of Preparation

The accounts have been prepared in a form determined by Scottish Ministers, in accordance with Section 30(1) of the Enterprise and New Towns (Scotland) Act 1990.

The accounts are prepared under the historical cost convention, modified to include the open market value of land and buildings held for industrial and commercial use.

They are prepared on a basis that takes account of the functions and objectives of Highlands & Islands Enterprise and its subsidiaries which, without limiting the information given, meet the requirements of the Companies Act 1985 and applicable accounting standards.

Basis of Consolidation

The Network accounts consolidate the accounts of Highlands & Islands Enterprise and its subsidiary undertakings drawn up to 31 March each year. Two of these, Careers Trust Scotland Limited and Scottish Health Innovations Limited, are funded in partnership with Scottish Enterprise. The consolidated accounts include the results of Careers Trust Scotland Limited in respect of its activities relating to the Highlands & Islands Enterprise network. The activities of Careers Trust Scotland Limited relating to Scottish Enterprise are consolidated within the Network accounts of Scottish Enterprise. The consolidated accounts do not include the results of Scottish Health Innovations Limited in respect of its activities relating to the Highlands & Islands Enterprise network. The activities of Scottish Health Innovations Limited relating to Scottish Enterprise are not consolidated within the Network accounts of Scottish Enterprise.

No income and expenditure account is presented for Highlands & Islands Enterprise as permitted by section 230 of the Companies Act 1985 and with the approval of Scottish Ministers.

Undertakings, other than subsidiary undertakings, in which the Network has an investment representing 20 per cent, or more than 20 per cent of the voting rights and over which it exerts significant influence are treated as associated undertakings. The Network accounts include Highlands & Islands Enterprise's share of the results and reserves of HIE Ventures Limited, based on audited accounts to 31 March 2003. In the opinion of Highlands & Islands Enterprise, none of the other minority investments conform to the definition of associated companies contained in the Financial Reporting Standard number 9.

Basis of Operations

Highlands & Islands Enterprise contracts with ten Local Enterprise Companies (LECs), which are companies limited by guarantee, for the creation and delivery of business development, training and environmental programmes at a local level. PICT Innovation Limited, a company limited by guarantee, was formed to promote and commercialise information and communication technology research and development within the Highlands and Islands area of Scotland. Careers Trust Scotland Limited, a company limited by guarantee, was formed to enable the advancement of education and training in Scotland. Scottish Health Innovations Limited, a company limited by guarantee, was formed to promote research and development within the National Health Service in Scotland particularly the commercialisation of research, technology and innovations. Business Information Source Limited, which is a wholly owned subsidiary, was originally formed to provide an information service to the Highlands and Islands but did not trade during the year. HIE Ventures Limited is a venture capital company aimed at companies operating in the Highlands and Islands.

Accounting for Grant-in-aid	Highlands & Islands Enterprise receives grant-in-aid from Scottish Ministers to finance its capital expenditure and the excess of its revenue expenditure over attributable income. Grant-in-aid is credited to general reserves and the net expenditure set against this on the basis that grant-in-aid cannot be allocated between revenue and capital expenditure as disclosed in the accounts.
European Union Funding and Other Grants	<p>Claims for funding relating to investments and capital building works in respect of assets are deducted from the additions to fixed assets. This is not in strict accordance with Schedule 4 to the Companies Act, which requires assets to be shown at their purchase price or cost and hence grants and contributions would be shown as deferred income. This departure is considered necessary to give a true and fair view as the assets involved are non-depreciating fixed assets and contributions would not be taken to the income and expenditure account. No funding relating to investment additions was received in the years ended 31 March 2002 and 31 March 2003. Additions to tangible fixed assets are reduced by £447,000 in the year to 31 March 2003, additions in the year to 31 March 2002 were £4,947,000 lower than they would otherwise have been.</p> <p>Grants receivable in respect of operating expenditure are credited to income in the period to which they relate.</p>
Land and Buildings	<p>Land and buildings held for industrial and commercial use are accounted for in accordance with the principles of Statement of Standard Accounting Practice 19 (SSAP 19) 'Accounting for Investment Properties', being included in the balance sheet on the basis of open market value as defined by the guidance notes issued by the Royal Institution of Chartered Surveyors. Professional, external valuations are carried out annually.</p> <p>Deficits arising on revaluation which are considered to be of a permanent nature are charged to the income and expenditure account under the commercial property revaluation adjustment (Note 11). Surpluses on revaluation are credited to a revaluation reserve after eliminating any accumulated deficit originally charged to the income and expenditure account in accordance with SSAP 19 (revised).</p> <p>The implications of Financial Reporting Standard 15 (FRS 15) 'Tangible Fixed Assets' have been considered in relation to the HIE Network. However, due to the nature of the tangible fixed assets held by Highlands & Islands Enterprise and its subsidiaries it is not considered appropriate to apply it to these accounts.</p>
Tenants' Improvements	Tenants' improvements are depreciated on a straight line basis over their useful life at rates of 4-25 per cent per annum.
Plant and Equipment	Plant and equipment are depreciated on a straight line basis over the useful life of the asset at rates of 25-33 per cent per annum.
Investments and Loans	Investments are shown at cost less provision for any diminution in value. No investments are valued at more than cost even though the underlying value may have increased. Loans are shown at the amount outstanding at the balance sheet date less provision for estimated losses.

Local Enterprise Company Assets and Investments	Tangible fixed assets and investments purchased by Local Enterprise Companies, in their own name with funds provided under the operating contract with Highlands & Islands Enterprise, are included in the accounts of the relevant Local Enterprise Company at cost or valuation less depreciation and provisions as appropriate. Under the terms of the operating contract, all sums due from the disposal of these assets and investments and income arising from these assets fall to be repaid to Highlands & Islands Enterprise. The net book value of these assets and investments is included in the balance sheet of Highlands & Islands Enterprise under debtors.
Stocks	Stocks are stated at market value.
Irrecoverable Income	Irrecoverable debts are written off at the earliest opportunity. Provision is made for debts which are considered unlikely to be recovered.
Leases	Assets acquired under finance leases are capitalised in the balance sheet and depreciated over their useful lives. The interest element of the rental obligations is charged to the income and expenditure account over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding. Rentals paid under operating leases are charged to the income and expenditure account on a straight line basis over the life of the lease.
Research Expenditure	All research expenditure is charged against revenue in the year it occurs.
Insurance	In line with central government policy, Highlands & Islands Enterprise bears its own liability for all risks except for statutory obligations. The Local Enterprise Companies are fully insured for all usual risks including employers' liability, public liability, directors' and officers' liability, property and contents cover and professional indemnity. PICT Innovation Limited is insured for contents, public liability, employers' liability and business interruption.
Taxation	<p>The companies in the Network are subject to corporation tax on their annual surplus as computed for taxation purposes.</p> <p>Provision is made for deferred taxation only when material liabilities are expected to arise in the foreseeable future.</p> <p>Provision for corporation tax is made on gains, profits and losses, as computed for tax purposes, arising from business activities.</p>

Pension Costs

Contributions are charged to the income and expenditure account so as to spread the cost of pensions over employees' working lives. A provision has been created to reflect the difference between employer's pension costs and the indicative funding level required by SSAP 24. This provision relates to those pensions which are met from grant-in-aid. Disclosure has also been made in compliance with Financial Reporting Standard 17 (FRS 17) 'Accounting for Pension Costs'.

2. Income from Operating Activities

Income, which is shown net of Value Added Tax (VAT), is made up of receipts from various bodies as detailed below:

	NETWORK	
	2003	2002
	£000	£000
European Regional Development Fund	312	281
European Social Fund	211	153
Other European contributions	4,110	4,151
Scottish Executive receipts	-	74
Property income (note 11)	5,341	3,827
Other external income	6,737	5,765
	<u>16,711</u>	<u>14,251</u>

All income shown relates to continuing activities.

3. Expenditure on Operating Activities

Expenditure is shown net of Value Added Tax (VAT) except where the VAT is irrecoverable.

	Growing Businesses £000	Global Connections £000	Skills & Learning £000	Strengthening Communities £000	Total £000	2002 £000
HIE	9,555	11,484	5,049	7,561	33,649	27,189
Argyll & the Islands	2,158	2,629	1,931	782	7,500	6,506
Caithness & Sutherland	1,155	1,407	1,161	679	4,402	3,372
Inverness & Nairn	1,036	1,261	1,723	355	4,375	3,686
Lochaber	1,161	1,414	841	409	3,825	2,342
Moray Badenoch & Strathspey	1,112	1,354	1,838	193	4,497	4,700
Orkney	605	736	667	235	2,243	2,067
Ross & Cromarty	1,137	1,385	2,040	668	5,230	5,415
Shetland	991	1,206	1,149	341	3,687	2,499
Skye & Lochalsh	523	638	346	319	1,826	1,974
Western Isles	1,241	1,511	1,463	748	4,963	5,315
Network	<u>20,674</u>	<u>25,025</u>	<u>18,208</u>	<u>12,290</u>	<u>76,197</u>	<u>65,065</u>
2002	16,937	20,628	17,117	10,383	65,065	

Property revaluation and management costs of £13,946,000 (2002 – £10,025,000) are included within growing businesses expenditure above (note 11).

Under the provision of Section 2(4) of the Enterprise and New Towns (Scotland) Act 1990, Highlands & Islands Enterprise bear the cost of allowances paid to participants on youth and adult training schemes administered by Local Enterprise Companies.

The adult training allowance is paid by the Department for Work and Pensions acting in their capacity as agents of Highlands & Islands Enterprise. The allowance is currently equivalent to an individual's benefit entitlement plus £10 per week training supplement. The total cost of adult training allowance, paid by the Employment Service on this basis for the year ended 31 March 2003, is £1,580,554 (2002 – £1,509,908) which is included in developing skills expenditure above.

Individual Learning Accounts – Under arrangements established by the Scottish Executive, Highlands and Islands Enterprise funded the cost of the Individual Learning Accounts (ILAs) programme in the Highlands and Islands Enterprise area. This was a programme through which individuals were entitled to financial support towards the cost of qualifying training courses. Highlands and Islands Enterprise made payments to a managing agent to enable the agent to make ILA payments to learning providers for learners in the Highlands and Islands Enterprise area. Highlands and Islands Enterprise was not responsible for the detailed management and administration of the programme but in terms of the Accountable Officer's responsibilities was required to operate arrangements for retrospective monitoring of payments made under the scheme. The managing agent administered the scheme in Scotland on behalf of, and in conjunction with, the Scottish Executive.

Allegations of irregularities in the operation of the ILA programme resulted in the parallel English scheme being suspended on 24 October 2001. The Scottish scheme was suspended on 23 November 2001 and closed on 20 December 2001. From November 2001 Highlands and Islands Enterprise withheld payments for all providers pending further investigation. Highlands and Islands Enterprise, in consultation with the Scottish Executive, extended its monitoring activity to undertake an extensive exercise to validate claims awaiting payment and to increase the checking of claims that had been paid. The ILA programme was subject to a report by the Auditor General For Scotland published in March 2003.

Highlands and Islands Enterprise extensive monitoring reviews identified a level of suspected irregular payments amounting to £33,000 where there is no evidence to confirm that the training has been undertaken. Highlands and Islands Enterprise's investigations were based on monitoring which covered 88% of provider activity including 43% of learning episodes at high risk providers.

In order to assess a potential level of non-compliance with the requirements of the programme, Highlands and Islands Enterprise applied the error rates identified from extensive sample checking to the claims from the individual learning providers where the irregularities had been identified. On the basis of this extrapolation, Highlands and Islands Enterprise estimated that potentially up to £86,000 of claims from learning providers may be irregular, £23,000 of which relates to payments which have not been made and £30,000 of which relate to occasions where learning had been received but the payments failed to comply with the scheme rules in some respects.

With the approval of the Scottish Executive in accordance with the policy guidelines, Highlands and Islands Enterprise made payments of £214,000 during the year ended 31 March 2003 for validated claims either in full or part settlement after taking account of the errors identified.

There are currently 8 outstanding claims under investigation; 1 of these cases had been referred to the Crown Office and 4 cases forwarded to the Department of Education and Skills as part of their ongoing investigation.

4a. Administration and Management Charges – by Organisation

	NETWORK	
	2003 £000	2002 £000
Highlands & Islands Enterprise	13,667	10,318
Argyll & the Islands Enterprise	1,071	910
Caithness & Sutherland Enterprise	745	743
Inverness & Nairn Enterprise	896	974
Lochaber Enterprise	540	645
Moray Badenoch & Strathspey Enterprise	1,404	1,103
Orkney Enterprise	508	447
Ross & Cromarty Enterprise	718	847
Shetland Enterprise	438	446
Skye and Lochalsh Enterprise	456	434
Western Isles Enterprise	941	1,195
Other	91	183
Network	<u>21,475</u>	<u>18,245</u>

4b. Administration and Management Charges

	NETWORK		HIE	
	2003 £000	2002 £000	2003 £000	2002 £000
This consists of:				
Staff costs (note 9)	14,319	11,262	9,615	6,436
Travel and subsistence - board members	21	20	21	20
Travel and subsistence - staff	1,221	821	765	442
Accommodation	1,729	1,745	1,091	1,006
Hospitality - board members	6	8	6	8
Hospitality - staff	69	64	43	36
Audit fees	182	194	126	107
Non-audit fees paid to auditors	13	10	-	-
Operating lease rentals - equipment	447	278	397	231
Depreciation of fixed assets	466	479	214	213
Equipment and furnishings	402	831	380	825
Provision for irrecoverable debts and losses	203	248	(192)	(174)
Other administration costs	2,397	2,285	1,201	1,168
	<u>21,475</u>	<u>18,245</u>	<u>13,667</u>	<u>10,318</u>

Administration Costs

The figures for 2002/03 indicate an increase of £3.2 million to £21.4 million. This reflects a number of strategic changes and one off items which can be summarised as follows:

	2002/03 £000
Careers Scotland - Salary Costs	2,645
Careers Scotland - Administration Costs	<u>1,250</u>
	3,895
Net underlying reduction in costs	<u>(665)</u>
Total	<u>3,230</u>

The net reduction in costs was achieved as part of the Evolving the Network where products, processes, systems, facilities and staffing have been reviewed across the HIE Network.

5. Notional Charges

In accordance with HM Treasury paper 'Executive Non-Departmental Public Bodies: Annual Reports and Accounts Guidance' issued in March 1996 the Network is required to account for the full cost of its activities.

The following notional charge has been included in the accounts:

	2003 £000	2002 £000
Interest charge	<u>3,312</u>	<u>3,091</u>

The notional interest charge is shown separately on the face of the Income and Expenditure Account and the corresponding credit is shown at the bottom of the same account. The charge is calculated on the basis of 6% on the average capital employed in the year.

6. Investment Income

	NETWORK	
	2003 £000	2002 £000
Dividends received	649	275
Loan interest receivable	262	342
Bank interest receivable	277	329
Surplus/(deficit) on disposal of investments	<u>3,956</u>	(40)
	<u>5,144</u>	906

7. Interest Payable

	NETWORK	
	2003 £000	2002 £000
Bank overdraft	-	1
Other	<u>3</u>	-
	<u>3</u>	1

8. Board Members' Remuneration

	NETWORK	
	2003 £000	2002 £000
Dr James Hunter (chairman)	53	41
Mr J R A Cumming	116	97
Other members (2002-11)	93	75
	262	213
Social security costs	22	17
Pensions to former members of the Highlands and Islands Development Board	71	71
	355	301

The remuneration of Mr J R A Cumming (chief executive) includes £14,060 relating to pension contributions. The chief executive is an ordinary member of the Highlands & Islands Enterprise superannuation scheme. Under the terms of the chief executive's contract of employment an annual bonus, subject to performance review, of up to 10 per cent (2002 – up to 10 per cent) of basic salary is payable. The review, conducted by the chairman, measures the chief executive's performance during the financial year against a series of targets set at the beginning of that year and relates to the performance of the HIE Network as a whole. Highlands & Islands Enterprise is required to meet the pension benefits due to former full-time chairmen and board members of Highlands & Islands Development Board and those of Highlands & Islands Enterprise who were not members of the superannuation scheme (as referred to in note 10).

Additional information as required by the Combined Code:

	Basic Salary	Performance Related Bonus	Total
	£	£	£
Dr James Hunter (chairman)	52,851	-	52,851
J R A Cumming (chief executive)	93,738	8,500	102,238
Mrs M Campbell	9,254	-	9,254
Mrs W Campbell	9,254	-	9,254
A Gray	9,254	-	9,254
J Gray	9,254	-	9,254
H Halcro-Johnston (resigned 30 September 2002)	4,538	-	4,538
D MacInnes	9,254	-	9,254
D Ratter (appointed 1 October 2002)	4,627	-	4,627
A Rogers	9,254	-	9,254
W Roe	9,254	-	9,254
G Sword	9,254	-	9,254
S Torrance	9,254	-	9,254
	239,040	8,500	247,540

(a) The above figures represent emoluments earned as directors during the relevant financial year with the exception of performance related payments which are disclosed above on a paid basis.

(b) During the year ended 31 March 2003 Mr J R A Cumming as chief executive, earned pension entitlements of £149. At 31 March 2003, Mr J R A Cumming had an accrued pension entitlement of £30,516 per annum.

9. Staff Costs

	NETWORK	
	2003 £000	2002 £000
Wages and salaries	13,075	9,833
Voluntary redundancy packages	426	891
Social security costs	936	714
Other pension costs	2,248	1,788
	16,685	13,226
Board members' remuneration (note 8)	355	301
	17,040	13,527

Of the total above, £14,319,157 (2002 – £11,262,081) relates to complement staff and board members. The balance relates to project staff.

During the year ended 31 March 2003, 14 staff accepted voluntary redundancy packages.

The remuneration and pension entitlements of senior members of the HIE Management Group for the year ended 31 March 2003 were as follows:

	Age	Salary including performance related pay	Pension entitlements earned	Accrued pension per annum
	£	£	£	£
J S Black (to 31 October 2002)	39	24,514	456	6,899
A B Brady	51	56,119	495	18,095
F Duthie	46	50,600	573	573
M Haswell	40	47,284	472	9,963
J D MacDiarmid	50	55,057	459	20,199
A Paterson	39	50,531	601	1,009
J A Watt (from 1 November 2002)	51	18,923	697	10,346
J F Wright (from 7 May 2002)	44	40,436	403	403

The average number of employees was as follows:

	NETWORK 2003 Number		NETWORK 2002 Number	
	Complement Staff	Total	Complement Staff	Total
Senior management	41	44	41	45
Training function	182	190	46	60
Enterprise function	137	217	118	187
Administration	115	126	84	104
Support staff	27	32	53	64
	504	609	342	460

The totals include project staff who work on fixed short-term contracts in support of a number of special initiatives.

10. Staff Pensions

Staff are members of the Highlands & Islands Enterprise superannuation scheme or local government pension schemes, with the exception of Caithness & Sutherland Enterprise. Following their transfer to Highlands & Islands Enterprise from their previous employers as part of the creation of Careers Scotland, some staff chose to remain with the Highland Council Pension Fund. Caithness & Sutherland Enterprise contributed to defined contribution personal pension schemes on behalf of certain employees; the assets of the schemes are held in independently administered funds. The local government pension schemes are defined benefit schemes, the assets of which are held in independently administered funds.

The Highlands & Islands Enterprise superannuation scheme provides benefits based on final pensionable salary. The assets of the scheme are held separately from those of Highlands & Islands Enterprise and are invested with independent investment managers agreed by the scheme's trustees. Contributions to the scheme are charged to the income and expenditure account so as to spread the cost of pensions over employees' working lives with the organisation. The contributions are determined by a qualified actuary on the basis of triennial valuations using the projected unit method. The most recent valuation was as at 6th April 2001. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. It was assumed that the investment returns would be 6.5 per cent per annum on assets held, 5.5 per cent per annum on future investments, that salary increases would average 4.5 per cent per annum and that present and future pensions would increase at the rate of 2.5 per cent per annum.

The most recent actuarial valuation showed that the market value of the scheme's assets was £28.4 million and that the actuarial value of those assets represented 83 per cent of the benefits that had accrued to members, after allowing for expected future increases in earnings.

The pensions for previous members of the Highlands and Islands Development Board with no service contracts, as well as the increases due to pensions for the members of the scheme who retired prior to 1st April 1991, are met from grant-in-aid. No allowance has been made for these pensions which are met from grant-in-aid in calculating the figure of 83 per cent shown above.

Employer contributions of 15.0 per cent, together with employee contributions of 1.5 per cent of pensionable salaries, have been paid during the year. The employer contribution is 20.4 per cent with effect from April 2003.

The pension charge for the period was £1,748,000 (2002 – £1,482,000).

A prepayment of £2.044 million (2002 – provision of £1.982 million) in respect of the period to 31 March 2003 is included in the balance sheet being the excess of the amount funded over the accumulated pension cost. The prepayment relates primarily to those pensions which are met from grant-in-aid.

Contributions are made to the following Local Government Pension Schemes by the HIE Network:

Highland Council Pension Fund
Orkney Islands Council Superannuation Scheme
Shetland Islands Council Superannuation Scheme
Strathclyde Pension Fund

The contributions to the Local Government Pension Schemes are determined by a qualified actuary on the basis of triennial valuations using the projected unit method. The results of the most recent valuations, which were conducted as at 31 March 2002 were as follows:

Main assumptions:

Rate of return of investments (% per annum)	5.9-6.3%
Rate of salary increases (% per annum)	4.1-4.3%
Rate of pension increases (% per annum)	2.6-2.8%

Market value of scheme assets (£ million)	£6,728.5M
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Level of funding, being the actuarial value of assets expressed as a percentage of the benefits accrued to members, after allowance for future salary increases	96-108%
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The pension charge for the period in respect of Local Government Pension Schemes was £484,000 (2002 – £265,000).

The contributions for the period in respect of the employees of Caithness & Sutherland Enterprise were £30,000 (2002 – £50,000).

Pension Disclosure under FRS17

Highlands & Islands Enterprise Superannuation Scheme

Highlands & Islands Enterprise operates a defined benefit scheme in the UK. A full actuarial valuation was carried out at 6 April 2001 and updated to 31 March 2003 by a qualified independent actuary. The major assumptions used by the actuary were (in nominal terms):

	31 March 2003 %	31 March 2002 %
Rate of salary increases (% per annum)	4.60	4.80
Rate of pension increase (% per annum)	2.60	2.80
Discount rate (% per annum)	5.40	6.00
Inflation rate (% per annum)	2.60	2.80

The assets in the scheme and expected rate of return were:

	Long-term rate of return expected at 31 March 2003 %	Value at 31 March 2003 £000	Long-term rate of return expected at 31 March 2002 %	Value at 31 March 2002 £000
Equities	6.50	17,998	7.00	22,320
Bonds	3.75	8,882	5.25	6,370
Cash	2.75	211	4.00	190
Total market value of assets		<u>27,091</u>		<u>28,880</u>
Actuarial value of liability		<u>(42,921)</u>		<u>(36,770)</u>
Deficit in the scheme		<u>(15,830)</u>		<u>(7,890)</u>
Related deferred tax asset/(liability)		-		-
Net pension liability		<u>(15,830)</u>		<u>(7,890)</u>

Local Government Pension Schemes

The valuation for the Local Government Pension Schemes used for FRS 17 disclosures has been based on the most recent actuarial valuations at 31 March 2002 and updated by a qualified actuary to take account of the requirements of FRS 17 in order to assess the liabilities of the schemes at 31 March 2003. Scheme assets are stated at their market value at 31 March 2003:

	31 March 2003 %	31 March 2002 %
Main assumptions:		
Rate of salary increases (% per annum)	4.0	4.3
Rate of pension increase (% per annum)	2.5	2.8
Discount rate (% per annum)	5.4	5.9
Inflation rate (% per annum)	2.5	2.8

The share of the assets in the schemes and the expected rate of return were:

	Long-term rate of return expected at 31 March 2003 %	Value at 31 March 2003 £000	Long-term rate of return expected at 31 March 2002 %	Value at 31 March 2002 £000
Equities	8.00	4,535	7.50	3,106
Bonds	4.80	1,053	5.50	631
Property	6.00	224	6.00	158
Cash	4.00	209	4.00	141
Estimated employer assets		6,021		4,036
Present value of scheme liabilities		(8,779)		(4,056)
Deficit in the scheme		(2,758)		(20)
Related deferred tax liability		-		(15)
Net pension liability		(2,758)		(35)

Reconciliation of net assets and reserves under FRS17

	2003 £000	2002 £000
Net assets		
Net assets excluding pension liability	55,636	50,591
Highlands & Islands Enterprise pension liability	(15,830)	(7,890)
Local Government pension liability	(2,758)	(35)
Net assets including pension liability	37,048	42,666
Reserves note		
Reserves excluding pension liability	55,636	50,591
Highlands & Islands Enterprise pension liability	(15,830)	(7,890)
Local Government pension liability	(2,758)	(35)
Reserves	37,048	42,666

	HIE Pension Scheme 2003 £ 000	Local Government Pension Schemes 2003 £ 000
Analysis of the amount charged to operating profit		
Current service cost	1,125	527
Past service cost	226	-
Curtailments and settlements	-	8
Total operating charge	<u>1,351</u>	<u>535</u>
Analysis of net return on pension scheme		
Expected return on pension scheme assets	1,917	506
Interest on pension scheme liabilities	(2,223)	(437)
Net return	<u>(306)</u>	<u>69</u>
Analysis of amount recognised in statement of total recognised gains and losses		
Actual return less expected return on scheme assets	(8,593)	(2,138)
Experience gains and losses on scheme liabilities	(217)	(18)
Changes in assumptions underlying the present value of scheme liabilities	(3,213)	(412)
Actuarial loss recognised in statement of total recognised gains and losses	<u>(12,023)</u>	<u>(2,568)</u>
Movement in surplus during the year		
Deficit in scheme at beginning of year	(7,890)	(196)
Movement in year:		
Current service cost	(1,125)	(527)
Past service costs	(226)	-
Contributions	5,740	472
Curtailments and settlements	-	(8)
Net return on assets/(interest cost)	(306)	69
Actuarial loss	(12,023)	(2,568)
Deficit in scheme at end of year	<u>(15,830)</u>	<u>(2,758)</u>

The actuarial valuation of the Highlands & Islands Enterprise Superannuation Scheme at 31 March 2003 showed an increase in the deficit from £7,890,000 to £15,830,000. Improvements in benefits costing £226,000 were made in the year ending 31 March 2003.

In the year ended 31 March 2003 Highlands & Islands Enterprise paid regular contributions of 15% of pensionable salaries. These contributions will increase to 20.4% of pensionable salaries with effect from 1 April 2003. In the year ended 31 March 2003 Highlands & Islands Enterprise also paid a lump sum of £4.5 million, plus a further lump sum of £353,000 representing the cost of granting enhanced early retirement benefits.

The pension contributions with effect from 1 April 2003 for the Local Government Pensions Schemes are:

Highland Council Pension Fund – LECs	12.9%
Highland Council – Careers Scotland	15%
Orkney Islands Council Superannuation Scheme	15%
Shetland Islands Council Superannuation Scheme	15.6%
Strathclyde Pension Fund	13.8%

	HIE Pension Scheme 2003 £ 000	Local Government Pension Schemes 2003 £ 000
History of experience gains and losses		
Difference between expected and actual return on scheme assets	(8,593)	(2,138)
Value of assets	27,091	6,021
Percentage of scheme assets	-32%	-36%
Experience gains and losses on scheme liabilities		
Present value of liabilities	(217)	(18)
Percentage of scheme liabilities	42,921	8,779
Percentage of scheme liabilities	-1%	-1%
Total amount recognised in statement of total recognised gains and losses		
Present value of liabilities	(12,023)	(2,568)
Percentage of scheme liabilities	42,921	8,779
Percentage of scheme liabilities	-28%	-29%

11. Commercial Property

	Notes	NETWORK	
		2003 £000	2002 £000
Income			
Rents receivable - operating leases		4,750	4,036
Less: rent concessions		-	(371)
		4,750	3,665
Profit on sales		591	162
	2	5,341	3,827
Expenditure			
Maintenance and factoring		3,834	1,459
Provision for bad debts		126	235
Revaluation adjustment - properties added during the year		6,442	5,392
Revaluation adjustment - properties held throughout the year		3,444	2,839
Share of operating and management costs		100	100
	3	13,946	10,025
Deficit		(8,605)	(6,198)

Reconciliation of Profit on Sales:

	NETWORK	
	2003 £000	2002 £000
Sales value of disposals	6,877	689
Net book value of disposals	6,286	527
Profit on sales	591	162

12. Taxation

	NETWORK	
	2003 £000	2002 £000
Corporation tax	21	30
Corporation tax under provided in previous years	6	1
Share of taxation of associated undertaking	244	-
	<u>271</u>	<u>31</u>

Corporation tax is charged at 30 per cent on the taxable surplus of Highlands & Islands Enterprise and charged at rates between 10 and 20 per cent on the taxable income of its subsidiaries.

Where liabilities for earlier years have not been finally agreed with the Inland Revenue, provision has been made for material estimated liabilities outstanding.

13. Tangible Fixed Assets

At 31 March 2003, industrial and commercial properties were valued on an open market value basis, in accordance with the guidance notes on the valuation of assets issued by the Royal Institution of Chartered Surveyors, at £36,354,725 (2002 – £40,171,520). The valuations were carried out by Ryden, property consultants.

NETWORK	Industrial and Commercial Property £000	Tenants' Improvements £000	Vehicles & Equipment £000	Total £000	2002 £000
Cost or market value					
At 1 April 2002	40,172	101	3,330	43,603	33,404
MBSE assets transferred	-	-	-	-	168
Additions	12,904	25	180	13,109	24,016
Disposals	(6,286)	-	(43)	(6,329)	(687)
European Regional Development Fund	(447)	-	-	(447)	(4,947)
Revaluations	(9,988)	-	-	(9,988)	(8,351)
At 31 March 2003	<u>36,355</u>	<u>126</u>	<u>3,467</u>	<u>39,948</u>	43,603
Depreciation					
At 1 April 2002	-	57	2,381	2,438	1,993
MBSE assets transferred	-	-	-	-	118
Charge for the year	-	6	460	466	479
Disposals	-	-	(40)	(40)	(152)
At 31 March 2003	-	<u>63</u>	<u>2,801</u>	<u>2,864</u>	2,438
Net book value					
At 31 March 2003	<u>36,355</u>	<u>63</u>	<u>666</u>	<u>37,084</u>	41,165
At 1 April 2002	40,172	44	949	41,165	31,411

Of the total net book value of £36,355,000 (2002 – £40,172,000) relating to industrial and commercial property as at 31 March 2003, £418,600 (2002 – £386,450) relates to leasehold sites.

HIE	Industrial and Commercial Property £000	Tenants' Improvements £000	Vehicles & Equipment £000	Total £000	2002 £000
Cost or market value					
At 1 April 2002	39,982	-	1,088	41,070	31,131
Additions	12,904	-	23	12,927	23,787
Disposals	(6,286)	-	(17)	(6,303)	(568)
European Regional Development Fund	(447)	-	-	(447)	(4,947)
Revaluations	(9,798)	-	-	(9,798)	(8,333)
At 31 March 2003	36,355	-	1,094	37,449	41,070
Depreciation					
At 1 April 2002	-	-	532	532	360
Charge for the year	-	-	214	214	213
Disposals	-	-	(15)	(15)	(41)
At 31 March 2003	-	-	731	731	532
Net book value					
At 31 March 2003	36,355	-	363	36,718	40,538
At 1 April 2002	39,982	-	556	40,538	30,771

Of the total net book value of £36,355,000 (2002 – £39,982,000) relating to industrial and commercial property as at 31 March 2003, £418,600 (2002 – £386,450) relates to leasehold sites.

The deficit arising on revaluation at 31 March 2003 consisted of:

	NETWORK		HIE	
	2003 £000	2002 £000	2003 £000	2002 £000
Deficit on properties added during the year	6,442	5,392	6,442	5,392
Decrease in valuation of property held throughout the year	3,546	2,959	3,356	2,941
	9,988	8,351	9,798	8,333

The deficit on properties added during the year is directly affected by the level of properties under construction at the year end. The valuation of such properties is made in accordance with standard Royal Institution of Chartered Surveyors statements of asset valuation and practice whereby each property is valued at an open market value on completion with an abatement for estimated costs to completion.

14. Investments

NETWORK	Shares £000	Loans £000	Total £000	2002 £000
Cost				
At 1 April 2002	6,266	5,420	11,686	12,742
MBSE investments transferred	-	-	-	76
Additions	876	830	1,706	841
Repayments	-	(1,189)	(1,189)	(1,429)
Disposals	(1,477)	-	(1,477)	(166)
Written off	(40)	(435)	(475)	(378)
At 31 March 2003	5,625	4,626	10,251	11,686
Diminution in value				
At 1 April 2002	2,648	3,325	5,973	6,365
MBSE investments transferred	-	-	-	25
Additions	570	(422)	148	13
Disposals	-	-	-	(46)
Written off	(40)	(433)	(473)	(384)
At 31 March 2003	3,178	2,470	5,648	5,973
Net book value				
At 31 March 2003	2,447	2,156	4,603	5,713
At 1 April 2002	3,618	2,095	5,713	6,377

At 31 March 2003, share investments of £2,447,000 (2002 – £3,618,000) consisted of equities of £672,000 (2002 – £898,000) and preference shares of £1,775,000 (2002 – £2,720,000).

At 31 March 2003, loan instalments due for repayment within one year amounted to £617,000 (2002 – £829,000).

HIE	Shares £000	Loans £000	Total £000	2002 £000
Cost				
At 1 April 2002	936	2,282	3,218	4,052
Additions	-	-	-	-
Repayments	-	(699)	(699)	(535)
Disposals	-	-	-	(51)
Written off	-	(142)	(142)	(248)
At 31 March 2003	936	1,441	2,377	3,218
Diminution in value				
At 1 April 2002	270	1,627	1,897	2,566
Additions	55	(292)	(237)	(375)
Disposals	-	-	-	(46)
Written off	-	(142)	(142)	(248)
At 31 March 2003	325	1,193	1,518	1,897
Net book value				
At 31 March 2003	611	248	859	1,321
At 1 April 2002	666	655	1,321	1,486

At 31 March 2003, share investments of £611,000 (2002 – £666,000) consisted of equities of £171,000 (2002 – £236,000) and preference shares of £440,000 (2002 – £430,000).

At 31 March 2003, loan instalments due for repayment within one year amounted to £186,000 (2002 – £283,000).

Details of subsidiary undertakings: all held by Highlands & Islands Enterprise unless indicated.

Name of company	Country of incorporation	Holding	Proportion of voting rights and shares held	Nature of business
Argyll & the Islands Enterprise Company	Scotland	n/a	n/a	Local Enterprise Company
Caithness & Sutherland Enterprise Company Limited	Scotland	n/a	n/a	Local Enterprise Company
Inverness & Nairn Local Enterprise Company	Scotland	n/a	n/a	Local Enterprise Company
Lochaber Enterprise	Scotland	n/a	n/a	Local Enterprise Company
Moray Badenoch & Strathspey Enterprise Company Limited	Scotland	n/a	n/a	Local Enterprise Company
Orkney Enterprise Limited	Scotland	n/a	n/a	Local Enterprise Company
Ross & Cromarty Enterprise Limited	Scotland	n/a	n/a	Local Enterprise Company
Shetland Enterprise Company Limited	Scotland	n/a	n/a	Local Enterprise Company
Skye & Lochalsh Local Enterprise Company Limited	Scotland	n/a	n/a	Local Enterprise Company
Western Isles Enterprise Company Limited	Scotland	n/a	n/a	Local Enterprise Company
Business Information Source Limited	Scotland	Ordinary shares	100%	Non-trading
PICT Innovation Limited	Scotland	n/a	n/a	Promote and commercialise information and communication technology research and development, within the Highlands and Islands area of Scotland.
Careers Trust Scotland Limited	Scotland	n/a	n/a	Enable the advancement of education and training in Scotland.
Scottish Health Innovations Limited	Scotland	n/a	n/a	Promote research and development within the National Health Service in Scotland particularly the commercialisation of research, technology and innovations.

Highlands & Islands Enterprise is a joint member, along with Scottish Enterprise, of Careers Trust Scotland Limited and Scottish Health Innovations Limited.

Scottish Health Innovations Limited was incorporated on 3 September 2002. The results of this company are not included in the HIE Network accounts as they are not considered to be material.

Details of associated undertakings: held by Highlands & Islands Enterprise.

Name of company	Country of incorporation	Holding	Proportion of shares held	Nature of business
HIE Ventures Limited	Scotland	Preference Shares	40%	Venture Capitalist
		Ordinary Shares	30%	
		'A' Ordinary Shares (non voting)	80%	

Details of investments in companies in which the Network total investment in shares and loans:

- (a) equals 20%, or more than 20%, of the voting rights and exceeds £100,000
 (b) the total investment exceeds £1,000,000

Name of company – activity	% of voting rights	Holding as at 31 March 2003	Shares Value Paid £000	Loan Outstanding £000
HIE Ventures Limited – Venture capitalist	30%	60,000 ordinary shares	60	*
		400,000 preference shares	400	-
		40,000 'A' non voting ordinary shares	40	-
Inverness Medical – Bio-medical research and production	-	1,000,000 preference shares	1,000	-
Investment in 151 other businesses			947	2,156
			2,447	2,156

*Loans of £1,000,000 netted off by ERDF received.

15. Stocks

Stocks comprise sheep, sheep quota and animal feedstuffs which are held on Orbst Estate.

16. Debtors

	NETWORK		HIE	
	2003 £000	2002 £000	2003 £000	2002 £000
Assets and investments held by Local Enterprise Companies (see below)	-	-	4,585	5,480
Other debtors	14,449	13,347	13,768	11,971
Provision for bad debts	(1,318)	(1,354)	(1,257)	(1,301)
	13,131	11,993	12,511	10,670
Taxation recoverable	2,003	924	1,832	940
Accrued income and prepayments	3,135	623	2,965	491
Owed by subsidiary undertakings	-	-	3,566	5,085
	18,269	13,540	25,459	22,666

Local Enterprise Companies purchase, in their own name, tangible fixed assets and investments with funds provided under the operating contract with Highlands & Islands Enterprise. Under the terms of the operating contract their value falls to be repaid to Highlands & Islands Enterprise on the disposal of such assets and investments. The sums due from these assets are attributable to the following:

	HIE	
	2003 £000	2002 £000
Land and property	-	151
Investments	4,244	4,892
Equipment	279	393
Tenants' improvements	62	44
	4,585	5,480

17. Cash at Bank and in Hand

	NETWORK		HIE	
	2003 £000	2002 £000	2003 £000	2002 £000
Network and HIE funds	1,230	494	2	1
Other scheme funds held	1,537	530	1,537	530
	2,767	1,024	1,539	531

The balance sheet includes funds held by Highlands & Islands Enterprise relating to the following schemes:

	NETWORK		HIE	
	2003 £000	2002 £000	2003 £000	2002 £000
Leader II	51	49	51	49
PESCA	-	4	-	4
SME	8	8	8	8
Nordic	-	7	-	7
Scottish Land Fund	453	424	453	424
Millennium Awards Fund	65	38	65	38
CED	709	-	709	-
Leader Plus	251	-	251	-
	1,537	530	1,537	530

Highlands & Islands Enterprise has been appointed by the Scottish Executive to act as the implementing authority for the European Union LEADER II and SME schemes in the Highlands and Islands.

The HIE Network is an applicant under CED and Leader plus schemes. The balance on these accounts represents advances from the Scottish Executive.

Highlands & Islands Enterprise has been contracted by The New Opportunities Fund to promote and administer the Scottish Land Fund in Scotland.

18. Creditors: amounts falling due within one year

	NETWORK		HIE	
	2003 £000	2002 £000	2003 £000	2002 £000
Other creditors	4,582	4,924	3,806	2,894
Accruals	1,063	1,588	597	1,284
Taxation and social security	505	273	505	273
Corporation tax	21	34	-	-
Prepaid rental income	508	458	508	458
Owed to subsidiary undertakings	-	-	7,058	8,645
	6,679	7,277	12,474	13,554

19. Creditors: amounts falling due after more than one year

	NETWORK		HIE	
	2003 £000	2002 £000	2003 £000	2002 £000
Deferred income – Other schemes	1,537	530	1,537	530
Pensions provision	-	1,982	-	1,982
	1,537	2,512	1,537	2,512

20. Provisions for Loss

	NETWORK				2002 £000
	Investments £000	Loan Capital £000	Revenue Debts £000	Total £000	
At 1 April 2002	2,648	3,325	1,354	7,327	7,328
MBSE provisions transferred	-	-	-	-	25
Written off	(40)	(433)	(217)	(690)	(509)
	2,608	2,892	1,137	6,637	6,844
Provisions for year:					
General	570	(422)	55	203	248
Commercial property	-	-	126	126	235
At 31 March 2003	3,178	2,470	1,318	6,966	7,327

During the year ending 31 March 2003 £632,166 (2002 – £82,987) in grants recoverable, 19 cases (2002 – 12 cases) were waived.

	HIE				2002 £000
	Investments £000	Loan Capital £000	Revenue Debts £000	Total £000	
At 1 April 2002	270	1,627	1,301	3,198	3,510
Written off	-	(142)	(215)	(357)	(373)
	270	1,485	1,086	2,841	3,137
Provisions for year:					
General	55	(292)	45	(192)	(174)
Commercial property	-	-	126	126	235
At 31 March 2003	325	1,193	1,257	2,775	3,198

During the year ending 31 March 2003 £nil (2002 – £42,867) in grants recoverable, nil cases (2002 – 2 cases) were waived.

21. Losses Statement

	NETWORK		HIE	
	No of Cases	£000	No of Cases	£000
Claims waived (amounts written off) during the year ended 31 March 2003	39	1,390,179	6	259,593

These write-offs relate to Scottish Executive approved balances and Highlands & Islands Enterprise delegated authority.

Detail of individual cases exceeding £100,000:

Caithness Peat Limited	£141,380
Kingswood Linen	£194,000
Ky-lin Limited	£364,126
Pro-Golf Limited	£128,632

Highlands & Islands Enterprise network continues to pursue all outstanding debts.

22. Reserves

NETWORK	Revaluation Reserve	Other Reserve	General Reserve	Total	2002
	£000	£000	£000	£000	£000
At 1 April 2002	282	1,033	51,468	52,783	45,132
MBSE reserves transferred	-	-	-	-	84
Grant-in-aid received during the year	-	-	78,793	78,793	75,618
	282	1,033	130,261	131,576	120,834
Transfer from Income and Expenditure Account	-	-	(74,841)	(74,841)	(68,191)
Other movements	(102)	(997)	-	(1,099)	140
At 31 March 2003	180	36	55,420	55,636	52,783

HIE	Revaluation Reserve	Other Reserve	General Reserve	Total	2002
	£000	£000	£000	£000	£000
At 1 April 2002	242	-	48,785	49,027	42,620
Grant-in-aid received during the year	-	-	78,793	78,793	75,618
	242	-	127,578	127,820	118,238
Transfer from Income and Expenditure Account	-	-	(77,167)	(77,167)	(69,108)
Other movements	(62)	-	-	(62)	(103)
At 31 March 2003	180	-	50,411	50,591	49,027

23. Net Cash Flow from Operating Activities

	NETWORK	
	2003 £000	2002 £000
Operating deficit	(80,961)	(69,059)
Adjustment for items not involving movement of cash:		
Increase in debtors	(1,853)	(1,682)
(Decrease)/increase in creditors	(513)	1,269
Decrease in stocks	10	3
Depreciation	466	479
Provisions and write offs	(3,912)	(781)
Profits on disposal of fixed assets	(589)	(159)
Revaluation of property	9,886	8,231
Net cash outflow from operating activities	<u>(77,466)</u>	<u>(61,699)</u>

24. Analysis of Cash Flows for headings in the Cash Flow Statement

	NETWORK	
	2003 £000	2002 £000
Returns on investments and servicing of finance		
Interest received	606	754
Dividends received	649	275
Interest paid	(3)	(1)
Net cash flow from returns on investments and servicing of finance	<u>1,252</u>	<u>1,028</u>
Taxation		
Corporation tax paid	(32)	(52)
Corporation tax received	7	61
	<u>(25)</u>	<u>9</u>
Capital expenditure and financial investment		
Loans advanced	(830)	(216)
Loans repaid	1,189	1,429
Payments to acquire shares	(876)	(625)
Receipts from the disposal of shares	5,433	155
Payments for the construction of property	(12,976)	(23,381)
Payments to acquire vehicles, equipment and tenants improvements	(205)	(877)
Receipts from the disposal of tangible fixed assets	6,878	694
Net cash flow from capital expenditure and financial investment	<u>(1,387)</u>	<u>(22,821)</u>
Financing		
Repayment of capital element of finance lease rentals	-	(4)
Deferred income repaid	1,007	(1,136)
Grant-in-aid received	75,000	75,618
European Regional Development Fund	3,362	1,899
Net cash flow from financing	<u>79,369</u>	<u>76,377</u>

25. Analysis of Net Funds

	At 31 March	Cash Flow	NETWORK Other Changes	At 31 March
	2002	£000	£000	2003
	£000	£000	£000	£000
Cash at bank and in hand	1,024	1,743	-	2,767
	1,024	1,743	-	2,767

26. Commitments and Contingent Liabilities

	NETWORK		HIE	
	2003	2002	2003	2002
	£000	£000	£000	£000
Commitments				
Local Enterprise Companies	-	-	See note (1) below	
Property ²	20,820	6,700	20,820	6,700
Grants and loans	20,118	10,731	-	-

(1) Contracts with all ten Local Enterprise Companies were renewed. The budgets offered for 2003-2004 totalled £58.50m (2002-2003 – £48.40m). Payments in respect of these budgets will be made partly by Highlands & Islands Enterprise on behalf of the Local Enterprise Companies.

(2) It is common practice during major construction projects for contractors to submit claims for escalation of costs. It is possible that claims may be lodged in respect of existing contracts.

27. Financial Commitments

Payments due under non-cancellable operating leases:

	NETWORK			2002 £000
	Property £000	Equipment £000	Total £000	
Operating and similar leases which expire:				
Within one year	94	34	128	155
Within two to five years	93	87	180	123
In over five years	726	-	726	839
	913	121	1,034	1,117

	HIE			2002 £000
	Property £000	Equipment £000	Total £000	
Operating and similar leases which expire:				
Within one year	94	30	124	136
Within two to five years	57	57	114	44
In over five years	484	-	484	469
	635	87	722	649

28. Transactions involving Board Members' Registered Interests

During the year the following transactions were made by the Highlands & Islands Enterprise network with businesses in which Highlands & Islands Enterprise board members had an interest:

Business	Approvals brought forward (£)	Amount approved/ (withdrawn) in year (£)	Amount paid in year (£)	Nature of transaction	Board member and interest
Morton Hotels	93,209	-	5,488	Building grant	G Sword – Director, Morton Hotels
Orkney Meat Ltd	16,688	9,834	12,843	Project, development and training grants	H Halcro-Johnston – Director, Orkney Meat Ltd
Ortak Jewellery Ltd	-	56,328	21,685	Project, development and training grants	A Gray – Director, Ortak Jewellery Ltd
Rocket Science UK Ltd	-	6,340	6,340	Fees	W Roe – Director, Rocket Science UK Ltd
Western Isles Sea Fisheries Training Association	-	33,000	20,848	Project grants	D MacInnes – Secretary, Western Isles Sea Fisheries Training Association
Western Isles Fishermen's Association	51,596	(34,096)	1,002	Project and development grants	D MacInnes – Secretary, Western Isles Fishermen's Association

Organisations which received funding in the year and in which the board members, key managerial staff or other related parties had a non-financial interest include:

Argyll College
 Caledonian Community Leisure Limited
 Eden Court Theatre
 Fusion Scotland
 Golf Highland Limited
 Inverness College
 Inverness Highland 2008
 Lochaber College
 Moray College
 Tenon Scotland
 The Highland Council
 University of the Highlands and Islands Millennium Institute

29. Related Party Transactions

Highlands & Islands Enterprise is a Non-Departmental Public Body sponsored by the Scottish Executive.

The Scottish Executive is regarded as a related party. During the year, Highlands & Islands Enterprise has had various material transactions with the Scottish Executive and with other entities for which the Scottish Executive is regarded as the parent body.

In addition, Highlands & Islands Enterprise has had a small number of material transactions with other Government departments, central government bodies, local government, non-departmental public bodies and similar organisations.

Material transactions have taken place with the:

Comhairle Nan Eilean Siar
Department for Work and Pensions
The Highland Council
Scottish Enterprise
Scottish Natural Heritage
Scottish Qualifications Authority
Shetland Islands Council
University of the Highlands and Islands Millennium Institute

None of the board members, key managerial staff or other related parties have undertaken any material transactions with Highlands & Islands Enterprise other than those disclosed in Note 28.

30. Rural Petrol Stations Grant Scheme

The HIE Network is involved in providing assistance under the Rural Petrol Stations Grant Scheme. Transactions relating to this scheme are as follows:

	NETWORK	
	2003	2002
	£000	£000
Funds brought forward at 1 April 2002	442	433
Funds received in the year	100	255
Monies paid out in the year	(107)	(246)
Funds carried forward at 31 March 2003	435	<u>442</u>

Accounts Direction

Direction by the Scottish Ministers to Highlands & Islands Enterprise: Accounts Direction 2002-2003

1. The Scottish Ministers, in pursuance of section 30(1) of the Enterprise and New Towns (Scotland) Act 1990, hereby give the following direction.
2. The statement of accounts which it is the duty of Highlands & Islands Enterprise to prepare in respect of the financial year ended 31 March 2002 and in respect of any subsequent financial year, shall comprise:
 - 2.1 a foreword;
 - 2.2 a consolidated income and expenditure account;
 - 2.3 a consolidated balance sheet;
 - 2.4 a Highlands & Islands Enterprise balance sheet;
 - 2.5 a consolidated cash flow statement;
 - 2.6 a consolidated statement of total recognised gains and losses;
 - 2.7 a statement of accountable officer's responsibilities; and
 - 2.8 a statement on the system of internal control.

Including such notes as may be necessary for the purposes referred to in the following paragraphs.

3. The statement of accounts shall give a true and fair view of the income and expenditure and cash flows for the financial year and the state of affairs as at the end of the financial year. Subject to this requirement, the accounts shall be prepared in accordance with:
 - 3.1 the accounting and disclosure requirements of the Companies Act for the time being in force; and
 - 3.2 generally accepted accounting practice in the UK, including accounting standards issued or adopted by the Accounting Standards Board; and
 - 3.3 guidance which Scottish Ministers may issue from time to time in respect of accounts which are required to give a true and fair view;
 - 3.4 the accounting and disclosure requirements given in "Government Accounting" and in "Executive NDPBs: Annual Reports and Accounts Guidance", as amended or augmented from time to time; and

insofar as these are appropriate to the Highlands & Islands Enterprise network and are in force for the financial year for which the statement of accounts is to be prepared.

4. Clarification of the application of the accounting and disclosure requirements of the Companies Act and accounting standards is given in Schedule 1 attached. Additional disclosure requirements are set out in Schedule 2 attached.
5. The income and expenditure account and balance sheet shall be prepared under the historical cost convention modified by the inclusion of:
 - 5.1 fixed assets at their value to the business by reference to current costs; and
 - 5.2 stocks valued at the lower of net current replacement cost (or historical cost if this is not materially different) and net realisable value.

6. This Direction shall be reproduced as an appendix to the statement of accounts. The direction given on 28 May 1997 is hereby revoked.

Signed by the authority of the Scottish Ministers

JANE MORGAN
Dated: 18 June 2002

Schedule 1

APPLICATION OF THE ACCOUNTING AND DISCLOSURE REQUIREMENTS OF THE COMPANIES ACT AND ACCOUNTING STANDARDS

Companies Act

1. The disclosure exemptions permitted by the Companies Act shall not apply with the exception of section 230 of the Companies Act 1985.
2. The Companies Act requires certain information to be disclosed in the Director's Report. To the extent that it is appropriate, the equivalent information relating to Highlands & Islands Enterprise shall be contained in the foreword. The foreword shall also contain a schedule analysing and summarising the cash out-turn by Scottish Executive funding block.
3. When preparing its income and expenditure account Highlands & Islands Enterprise shall have regard to the profit and loss account format 2 prescribed in Schedule 4 to the Companies Act. The format of the income and expenditure account should disclose on the face of the account:
 - 3.1 income, expenditure and net surplus/deficit on operating activities;
 - 3.2 other income;
 - 3.3 other expenditure;
 - 3.4 taxation;
 - 3.5 appropriations;
 - 3.6 the excess of expenditure over income after appropriations; and
 - 3.7 transfers to reserves.
4. When preparing its balance sheet Highlands & Islands Enterprise shall have regard to the balance sheet format 1 prescribed in Schedule 4 to the Companies Act.
5. Highlands & Islands Enterprise is not required to provide the additional information required by paragraph 33(3) of Schedule 4 to the Companies Act, nor to comply fully with the disclosure requirements re investments of section 231 of the Companies Act 1985 (specifically those specified in Schedule 5, Part 11, paragraphs 23 to 28).
6. The foreword and balance sheet shall be signed and dated by Highlands & Islands Enterprise's Accountable Officer and the annual accounts submitted to the Scottish Ministers on or before the last day of October following the end of the financial year to which they relate.

Accounting Standards

7. Highlands & Islands Enterprise is not required to include a note showing historical cost profits and losses as described in FRS3.
8. Highlands & Islands Enterprise shall not adopt the Financial Reporting Standard for Smaller Entities.

Accounting Policies

9. The accounting policies adopted by Highlands & Islands Enterprise shall include the following:
 - 9.1 Grant-in-aid received by Highlands & Islands Enterprise shall be credited to a general reserve on the basis that grant-in-aid cannot be allocated between revenue and capital expenditure as disclosed in the accounts.

- 9.2 Land and buildings held for industrial or commercial use shall be accounted for in accordance with the principles of Statement of Standard Accounting Practice 19 "Accounting for Investment Properties", being included in the balance sheet at open market value on the basis of annual revaluations, which should be conducted by an independent firm of professional valuers at least every five years.

Schedule 2

ADDITIONAL DISCLOSURE REQUIREMENTS

1. The foreword shall, *inter alia*:
 - 1.1 state that the statement of accounts have been prepared in a form directed by the Scottish Ministers in accordance with section 30(1) of the Enterprise and New Towns (Scotland) Act 1990.
 - 1.2 include a brief history of Highlands & Islands Enterprise and its statutory background.

2. The notes to the accounts shall include:
 - 2.1 details of any key corporate financial targets set by the Scottish Ministers together with an indication of the performance achieved; and
 - 2.2 details of the pension arrangements operated by Highlands & Islands Enterprise and confirmation that the scheme accords with the guidance contained in "Non-Departmental Public Bodies : A guide for Departments";
 - 2.3 disclosure of the income, expenditure and net surplus or deficit of Commercial Property Activities;
 - 2.4 an analysis of other income;
 - 2.5 an analysis of operating costs, showing training allowances costs, in categories consistent with 'Smart Successful Scotland';
 - 2.6 an analysis of management costs;
 - 2.7 an analysis of bad and doubtful debts and miscellaneous losses;
 - 2.8 the accumulated figure of financing provided by grant-in-aid since the incorporation of Highlands & Islands Enterprise;
 - 2.9 details of the property valuation in appropriate categories together with the revaluation adjustment required to bring the original cost to market value. The basis of the valuation should be clearly stated and any comments, including those of the valuers, on the basis and limitations of the valuation which will assist the reader of the accounts in assessing the value of the portfolios should be provided;
 - 2.10 an analysis of property related items in the income and expenditure account to show surpluses/ deficits on sales of property by reference to the net book amount at the beginning of the year of sale; adjustments in respect of land purchased or held and property developments contracted or in progress during the year; and adjustments in respect of changes in the value of investment property held throughout the year;
 - 2.11 an analysis of the movements on all reserves;
 - 2.12 the insurance arrangements of the Highlands & Islands Enterprise network;
 - 2.13 an analysis of expenditure on travel and subsistence and entertaining, separately disclosing expenditure in respect of board members and staff;

- 2.14 the average, full-time equivalent number of employees, whether permanent or temporary, employed in the Highlands & Islands Enterprise network, analysed in appropriate categories to disclose at least the following:
- Senior management (that is, the holders of those posts identified in paragraph 1.6.1 of the Management statement of Highlands & Islands Enterprise);
 - Operations;
 - Administration and support functions.
- 2.15 The total sum paid to each Local Enterprise Company analysed by funding block (alternatively, this disclosure may be provided in the Foreword);
- 2.16 The guarantees and contingent liabilities provided by the Highlands & Islands Enterprise network in the following categories:
- joint ventures or property investments underwritten;
 - liability arising from legal action;
 - guaranteed loan and bank overdrafts of companies in which the Highlands & Islands Enterprise network has invested;
 - guarantees to banks in respect of property sales;
 - any other guarantees or liabilities;
- 2.17 a schedule of all investments showing:
- I) in respect of companies in which the Highlands & Islands Enterprise Network holds 20% or more than 20% of the voting rights and where the total investment (including loans) is in excess of £100,000:
- a. Name of company
 - b. Nature of its business
 - c. Percentage of voting rights held
 - d. Amount invested in shares (distinguishing between ordinary and preference shares)
 - e. Amount of loan given to each company
 - f. Any other commitments in respect of each company.
- II) in respect of companies in which Highlands & Islands Enterprise network holds less than 20% of the voting rights but where the total investment (including loans) is in excess of £1,000,000:
- a. Name of company
 - b. Nature of its business
 - c. Percentage of voting rights held
 - d. Amount invested in shares (distinguishing between ordinary and preference shares)
 - e. Amount of loan given to each company
 - f. Any other commitments in respect of each company.
- III) in respect of all other investments by Highlands & Islands Enterprise network:
1. Total number of companies involved
 2. Total amount invested
 3. Total amount of loans given
 4. Total amount of any other commitments.

A report by the Auditor General for Scotland under Section 22(3) of the Public Finance and Accountability (Scotland) Act 2000

The 2002/03 Audit of Highlands and Islands Enterprise

1. I have received the audited accounts of Highlands and Islands Enterprise for the year ended 31 March 2003. The auditor's report on the accounts is not qualified but I have decided to issue this report to bring to Parliament's attention an issue concerning financial support to Skerries Salmon Ltd (SSL) which was raised by the auditor during the course of the audit.
2. I submit these accounts and the auditor's report in terms of sub-section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report which I have prepared under sub-section 22(3) of the Act.
3. SSL, a company engaged in salmon aquaculture, is located on the group of islands called Out Skerries, 12 miles east of the Shetland mainland. Out of a population of 75, six work full-time and 12 part-time for the company. In late March 2003, Shetland Enterprise (SE) presented a paper to the Highlands and Islands Enterprise (HIE) Management Group seeking approval to pay £193,000 grant assistance to SSL. The HIE Management Group subsequently became aware that, contrary to established procedures, the application did not refer to SE's payment of £100,000 to SSL made three weeks earlier. HIE's Chief Executive therefore asked Internal Audit to review the payment of grant to SSL.
4. Internal Audit found that in February 2003, a director of SSL who was also a board member of SE, approached SE about the possibility of obtaining financial assistance to help ensure the company's long-term future through diversification from salmon farming into the production of cod and halibut.
5. In March 2003, SSL confirmed to SE that its bankers were unable to extend its overdraft facility, and that feed suppliers were not being paid and had withdrawn their services. SE considered that in order to buy time to consider the longer-term future of SSL, and due to the current number of existing loans about to mature, grant assistance was the only option.
6. SE recommended to HIE assistance of £200,000 to SSL. HIE expressed concern about the case for grant support as it existed at that time and was not prepared to support it as presented. However, the SE Chief Executive decided to approve assistance up to the full amount of his delegated authority of £100,000. The SE Chief Executive's decision was based on the serious financial position in which the applicant found itself and in view of the Enterprise Network's key objective to foster economic activity in areas of declining population such as Out Skerries. SE's payment of £100,000 grant to SSL was authorised on 12 March 2003.
7. At the same time this assistance was being approved, SE also prepared a case for a £193,000 grant. This paper was recommended for approval at a meeting of the SE Board on 27 March 2003. However, because the £193,000 exceeded

the SE delegated authority, the proposal was presented to the HIE Management Group four days later. The HIE Management Group deferred a decision on this case and invited SE to look more thoroughly at the viability of the business and its diversification plans.

8. HIE Internal Audit found several areas of concern associated with both the payment of £100,000 grant and the proposal for further grant assistance:

Payment of £100,000

- Normal procedures for the consideration and approval of grant were not followed. In particular:
 - There was a lack of background investigation of the SSL project in preparing the case for grant assistance
 - The financial viability of SSL was not judged using other information available at the time. For example, while SE stated that “the business has every chance of being viable, if the proposals are implemented”, SSL’s financial projections highlight long term concerns regarding its viability
 - There was no application form or notes of meetings with SSL on file
 - The legal agreement was not signed by a SE representative, and the applicant’s signature does not record a date of signing
- SSL was informed that SE would provide assistance of £100,000 before it was approved and after HIE deferred support for the project as presented
- The level of assistance provided was based on the SE Chief Executive’s maximum delegated authority rather than on need. Initial projections did not indicate that £100,000 would be sufficient funding
- The assistance provided could be construed as a rescue package. As such the assistance was not in accordance with the Management Statement governing the relationship between the Scottish Executive and HIE. The Management Statement states that “HIE must be satisfied about the financial viability of any commercial venture involved in a project and should not give assistance to projects where it believes the financial viability is in serious doubt”. The SE Chief Executive’s view, however, was that the grant assistance was necessary to ensure SSL’s short-term survival and to enable it to implement its diversification plans, and that the company was viable.

Proposal for further grant assistance

- As with the payment of £100,000 grant, there was a lack of robust investigation of SSL and due diligence. In particular, the proposal for further grant assistance did not specifically refer to the £100,000 paid earlier

- There was confusion as to whether the proposal for further grant assistance of £193,000 included, or was additional to, the £100,000 grant already paid. The SE Chief Executive subsequently explained that it was always intended that the £193,000 included the £100,000 payment. However, if the proposal for further grant assistance had been approved, there were no systems controls to prevent payment of £293,000
 - There was no application form or notes of meetings with SSL on file
 - Although he declared an interest, the SSL director was present at the SE Board meeting when the proposal for further grant assistance was presented. Although this is contrary to HIE Network procedures, the SE Board members agreed that he should remain in attendance to answer questions.
9. Following receipt of Internal Audit's report, the HIE Chief Executive took action to address its findings. The SE's delegated authority limit was reduced to £25,000. SE's Chief Executive was given a final written warning principally for failing to follow proper procedures for project investigation and for approval of grant assistance. The HIE Chief Executive met with the SE Board Chairman and Audit Committee to emphasise the need for full compliance with HIE's Code of Practice for Board Members. HIE's Directorate of Growing Business also put in place a programme of training and support for SE development staff. In addition, HIE reviewed all relevant projects to establish if any other potential issues of non-compliance existed. No material issues were found. Finally, HIE commissioned a firm of accountants to review SSL's financial health; a review of options for diversification was undertaken; and SSL has recently developed a diversification plan.
10. HIE is to be commended for promptly undertaking an Internal Audit Review and for taking prompt action to address their findings. It is still, however, a source of concern that SE disregarded procedures for the consideration and approval of grant in such a fundamental way. I would urge HIE to take all relevant steps to ensure local enterprise companies comply with their responsibilities for the proper use of public money.



Robert W Black

Auditor General for Scotland

9 October 2003

