

Scottish Environment Protection Agency

Report on the 2006/07 Audit



September 2007



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Executive Summary

Introduction

In 2006/07 we audited the financial statements of the Scottish Environment Protection Agency (SEPA) and we looked at aspects of performance management and governance. This report sets out our key findings.

Financial Position

We have given an unqualified opinion on the financial statements of SEPA for 2006/07.

The new FReM requirement to account for grant-in-aid as a credit to reserves has resulted in an excess of expenditure over income for the year of £32.936 million in 2006/07 (2005/06 result restated to reflect the change in accounting policy: £31.759 million excess expenditure). The grant-in-aid credited to reserves for the year was £33.566 million (2005/06: £34.147 million).

SEPA's balance sheet at 31 March 2007 showed net liabilities of £9.277 million (2005/06 net assets of £8.274 million). This movement was mainly caused by the impact of the deficit on the pension scheme £24.774 million at 31 March 2007, an increase of £17.304 million from last year's liability. The increased deficit is due to a reduction in the discount rate from 2.8% to 2.1%. The accounts were prepared on a going concern basis as the Board believes that the pension scheme liabilities will be met through future grants or grant-in-aid from the Scottish Executive and future income from charging schemes.

SEPA operated within the budget limits set by the Scottish Executive for capital expenditure, operating expenditure and cost of capital.

Performance

In 2006/07 SEPA achieved 97% (2005/06: 99%) cost recovery across all charging schemes. The most significant under recovery was in relation to the Pollution Prevention & Control (PPC) scheme and we note that Ministerial approval has been given for an increase to the PPC scheme of RPI plus 5% for 2007/08.

In 2006/07 SEPA achieved 19 out of 22 operational targets with two classed as "near misses" (2005/06: 16 targets achieved with one "near miss"). These targets cover six high-level outcomes which are waste management, water, land and air quality, environment and economic well being. SEPA reported key achievements under each of these outcomes and these included the publication of the business waste framework and the achievement of all of its surface water quality targets.



As part of its commitment to the Efficient Government Initiative, SEPA agreed efficiency targets of £4.1 million for the three years to 2008/09 with the Scottish Executive.

SEPA has reported achievement of efficiency savings of £4.7 million in 2006/07. This compares with efficiency saving targets of £4 million set for 2006/07. SEPA has achieved its three year target by year two.

Governance

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. Overall the corporate governance and control arrangements for SEPA operated satisfactorily during the year, as reflected in the Statement on Internal Control.

Looking Forward

SEPA has set an initial balanced budget for 2007/08 and has instigated a number of reviews to identify efficiency savings and is also working in partnership with other government bodies to provide joint accommodation solutions and share support services. These savings will ensure a balanced budget is achieved for 2008/09 and onwards. We will monitor the progress made by SEPA in achieving the efficiency savings.

As part of the 2007/08 audit we will be reviewing the progress that the Scottish Environment Protection Agency has made in strengthening their arrangements for securing Best Value since our baseline review work in 2005/06.

Audit Scotland
September 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of SEPA. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 13 March 2007. This plan described the work we planned to carry out on financial statements, performance and governance.
2. This is the first year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of SEPA during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk.



Financial Statements

3. In this section we summarise key outcomes from our audit of SEPA financial statements for 2006/07, and comment on the key financial management and accounting issues faced.

Our Responsibilities

4. We audit the financial statements and give an opinion on whether:
 - they give a true and fair view of the financial position of SEPA and its expenditure and income for the period in question,
 - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements, and
 - the regularity of the expenditure and receipts.
5. We also review the statement on internal control by:
 - considering the adequacy of the process put in place by the chief executive as accountable officer to obtain assurances on systems of internal control, and
 - assessing whether disclosures in the statement are consistent with our knowledge of SEPA.

Overall Conclusion

6. We have given an unqualified opinion on the financial statements of SEPA for 2006/07.

Financial Position

2006/07 outturn

7. The new FReM requirement to account for grant-in-aid as a credit to reserves has resulted in an excess of expenditure over income for the year of £32.936 million in 2006/07 (2005/06 result restated to reflect the change in accounting policy: £31.759 million excess expenditure). The grant-in-aid credited to reserves for the year was £33.566 million (2005/06: £34.147million).
8. SEPA's balance sheet at 31 March 2007 showed net liabilities of £9.277 million (2005/06 net assets of £8.274 million). This movement was mainly caused by the impact of the deficit on the pension scheme £24.774 million at 31 March 2007, an increase of £17.304 million from last year's liability. The increased deficit is due to a reduction in the discount rate from 2.8% to 2.1%. The accounts were prepared on a going concern basis as SEPA believes that the pension scheme liabilities will be met



through future grants or grant-in-aid from the Scottish Executive and future income from charging schemes.

9. The total grant-in-aid allocated to SEPA from the Scottish Executive during the year was £36.266 million (2005/06: £34.147 million). Of the £36,266 million allocated, £33.566 million was drawn down in cash during the year and the remaining £2.7 million was carried forward to meet the costs of pay restructuring in 2007/08.
10. SEPA operated within the budget limits set by the Scottish Executive for capital expenditure, operating expenditure and cost of capital.

2007/08 budget

11. SEPA has set an initial balanced resource budget of £70.442 million for 2007/08. This comprises:
 - an initial £37.599 million cash grant-in-aid which is an increase of £4.1 million over 2006/07 and includes the £2.7 million funding for the pay award increase carried forward from 2006/07,
 - charging scheme income and other income of £32.843 million, and
 - total expenditure of £70.442 million including capital charges of £2.488 million.
12. Grant-in-aid settlement figures have been approved for 2007/08. The grant-in-aid allocated to SEPA has not been uplifted for general inflation as this is expected to be met from SEPA's efficiency savings each year.
13. SEPA continue to face financial pressure from the new duties resource requirements and volatility of charging scheme income and the potential increased costs arising from job evaluation and pay restructuring.

Issues Arising from the Audit

14. We reported the following issue to the Audit Committee on 4 July 2007:
15. **Unadjusted errors:** Several errors were identified during the audit, where if adjustments were made, these would have a net effect of increasing by £38,654 the excess of expenditure over income for the year shown in the income and expenditure account. The net impact on the balance sheet would be that net assets would decrease by £38,654. These errors while more than clearly trifling are immaterial to the accounts as a whole. Officers in finance did not adjust the accounts for these errors and we concur on this.



Statement on Internal Control

16. The Statement on Internal Control provided by SEPA's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out SEPA's approach to this.

Regularity Assertion

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



Performance

18. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
19. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

Performance

20. SEPA has a target of full cost recovery on chargeable services. In 2006/07 SEPA achieved 97% cost recovery across all the charging schemes (2005/06: 99%). Full costs were not recovered for eight of the schemes and the most significant (£0.601m) under recovery was in relation to the Pollution Prevention & Control (PPC) scheme. In addition we note that Ministerial approval has been given for an increase to the PPC scheme of RPI plus 5% for 2007/08.
21. SEPA are responsible for the regulation of activities that may pollute water, air, land, storage, transport and disposal of waste; and keeping and disposal of radioactive materials. These responsibilities have been interpreted into six high level outcomes which are: minimised, recovered and well managed waste; good water environments; good air quality; good land quality; a respected environment; and economic well being. SEPA are set key targets covering these outcomes. In 2006/07 SEPA achieved 19 out of 22 targets with two classed as "near misses" (2005/06: 16 targets achieved with one "near miss"). SEPA reported key achievements under each of the outcomes and these included the publication of the business waste framework and the achievement of all of its surface water quality targets.



Governance

Overview of Arrangements

22. This section sets out our main findings arising from our review of SEPA governance arrangements.

This year we reviewed:

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

23. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position (see paragraphs 7-10). Our overall conclusion is that arrangements within SEPA are sound and have operated throughout 2006/07.

Systems of Internal Control

24. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In their annual report for 2006/07, KPMG, the internal auditors, provided an opinion that, based on the internal audit work undertaken during the year, SEPA's systems provide an adequate basis for maintaining control and that the control framework provides adequate assurance regarding the effective and efficient achievement of the objectives of SEPA.

25. As part of our audit we reviewed the high level controls in a number of SEPA's systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively and there were no issues from our work which merited disclosure within the Statement on Internal Control in the 2006/07 accounts.

Internal Audit

26. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2006/07 audit we assessed whether we could place reliance on SEPA's internal auditors - KPMG. We concluded that the internal audit service operates in accordance with the Government Internal Audit Manual and therefore placed reliance on a number of internal audit reviews.



Information and Communication Technology

Computer Service Review

27. As part of our risk based assessment, we identified Information and Communication Technology (ICT) as a priority area for review in 2006/07. Management were asked to complete a Computer Service Review client questionnaire (CSR-CQ) and we reported our detailed findings from this exercise separately in our draft report issued in August 2007.
28. The seven key areas covered by the review were; ICT strategy, organisational structure, installation management, service delivery, asset protection and security, business continuity/ contingency and data networking.
29. We identified some examples of good practice, in particular implementing an Information Management Strategy Group with responsibility for IS strategy. We also identified areas where improvements can be made in particular undertaking annual Business Continuity testing throughout the organisation. During our review we identified a number of areas where SEPA are making progress and we plan to keep these topics in view and will monitor progress in the future.



Looking Forward

30. SEPA faces a number of challenges in 2007/08, which include:

- **Charging schemes** – SEPA continue to face challenges in meeting their target of full cost recovery across its charging schemes. Ministerial approval has been given for an increase to the PPC scheme above the rate of inflation and we will continue to monitor progress in meeting its full cost recovery target.
- **Financial budgets** – SEPA has set an initial balanced budget for 2007/08. SEPA recognise the financial pressures resulting from the new duties resource requirements and volatility of charging scheme income and the potential increased costs arising from job evaluation and pay restructuring. SEPA has instigated a number of reviews to identify efficiency savings and is also working in partnership with other government bodies to provide joint accommodation solutions and share support services. SEPA will need to ensure these savings are delivered during 2007/08 to ensure a balanced budget can be achieved in 2008/09 onwards.
- **Single environment and rural service (SEARS)** – The Minister has asked the “On the Ground family” which comprises SEPA, Scottish National Heritage, the Forestry Commission, National Parks, Deer Commission, Crofters Commission, Scottish Executive Rural Payments and Inspections Directorate and the Animal Health Agency to develop a proposal for closer, more efficient, “joined up” working within existing legal and organisational frameworks. The proposal must be ready for implementation by June 2008. SEPA will have a key role in developing the service and this will be a challenge over the coming year.
- **Best Value** - As part of the 2007/08 audit we will be reviewing the progress that the Scottish Environment Protection Agency has made in strengthening their arrangements for securing Best Value since our baseline review work in 2005/06. Over the next year we will also be developing and refining our approach to the audit of public bodies’ arrangements to secure economy, efficiency and effectiveness in the use of resources, as this is one of our key objectives as auditors, set out within the new Code of Audit Practice approved by the Auditor General. This will inform our ongoing work to develop an approach to the audit of Best Value across the Scottish public sector. We intend to consult with both clients and stakeholders at key stages of these initiatives.