

# Scottish Natural Heritage

Report on the 2007/08 Audit



October 2008



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# Executive Summary

## Introduction

In 2007/08 we looked at the key strategic and financial risks being faced by Scottish Natural Heritage (SNH). We audited the financial statements and we also reviewed aspects of performance management and governance. This report sets out our key findings.

## Financial Position

SNH met its key financial target to stay within its resource budget this year. The organisation had a total resource budget of £71.433 million for 2007/08. The outturn for 2007/08 was an underspend of £0.6 million, or 0.8% of the overall resource budget.

Scottish Ministers have agreed a Grant in Aid (GIA) resource budget for SNH of £67.2 million for 2008/09. Funding for 2009/10 and 2010/11 has been set at £69.7 million and £71.4 million respectively. SNH has highlighted a number of risks to achieving the resource budget for 2008/09, and is also required to make a 2% per annum efficiency saving which is reflected in each of the next three years' budget settlement. These will be challenging targets for SNH to achieve, and we will continue to keep developments in this area under review.

## Financial Statements

We have qualified our opinion on the financial statements of SNH for 2007/08, in relation to the limitation in scope of the audit work arising from uncertainty over the regularity of payments under management agreements entered into prior to 1 January 2000. During the year, SNH made payments of £1.4 million under these agreements, which in the absence of European sanction, may be deemed irregular.

With the exception of the pre 2000 management agreements, we have concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

## Performance

SNH achieved eight of the nine performance targets agreed with the Scottish Government. These targets are drawn from SNH's corporate plan and cover areas such as biodiversity, access to the countryside, land management, and efficient government initiatives. The target to bring 80% of special features on nature sites into favourable condition by March 2008 was not achieved, however good progress was made to achieve 77.5% of features assessed as being in favourable condition. Achieving the target of 95% sites in favourable condition by 2010 will be challenging, with changes in the management arrangements for these sites. We will continue to monitor progress in this area.



## **Best Value**

SNH has continued to embrace Best Value through its development programme. re-assessing itself against the Scottish Government self assessment questionnaires, and defining focus areas for 2008/09. We will review aspects of SNH's Best Value arrangements further through the implementation of a financial management toolkit in the autumn.

## **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 SNH operated satisfactorily during the year, as reflected in the Statement on Internal Control.

We examined the key financial systems which underpin the organisation's control environment. We concluded that financial systems and procedures operated sufficiently well to enable us to place reliance on them.

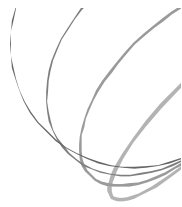
## **Looking forward**

The final part of our report notes some future key risk areas for SNH. We have highlighted a number of national issues which affect all public sector bodies such as SNH, including the introduction of Scotland Performs; the impact of international financial reporting standards; and the review of data handling arrangement in public bodies across Scotland. SNH also faces significant financial pressure in achieving the resource budget for 2008/09 and beyond. We will continue to monitor SNH's financial planning arrangements and financial position.

The assistance and co-operation given to us by Board members and staff during our audit is gratefully acknowledged.

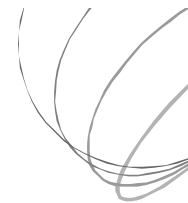
**Audit Scotland**

**October 2008**



# Introduction

1. This report summarises the findings from our 2007/08 audit of SNH. The scope of the audit was set out in our Audit Plan, which was agreed with management in March 2008 and presented to the Audit and Risk Management Committee on 2 June 2008. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued a range of reports this year, and we briefly touch on the key issues we raised in this report. Each report set out our detailed findings and recommendations and the Board's agreed response.
3. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of SNH 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](http://www.audit-scotland.gov.uk).



# Financial Position

4. In this section we summarise key outcomes from our audit of SNH's financial statements for 2007/08, and comment on the key financial management and accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

## Our responsibilities

5. We audit the financial statements and give an opinion on:
  - whether they give a true and fair view of the financial position of SNH and its expenditure and income for the period in question
  - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
  - the consistency of the information which comprises the Basis of Accounts, Statutory Background, Principal Activities, SNH Board and Management Team, Key Performance Targets, Results For the Year, Valuation of Land and Buildings, Activities in the Field of Research and Development, Events After the Balance Sheet Date, State Aids, Supplier Payment Policy, Best Value, Corporate Diversity, Communication and Employee Involvement, Auditors, and Disclosure of Information to the Auditors, included in the Annual Report, with the financial statements
  - the regularity of the expenditure and receipts.
6. 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 SNH.

## Overall conclusion

7. We have given a qualified opinion on the financial statements of SNH for 2007/08, in relation to the limitation in scope of the audit work arising from uncertainty over the regularity of payments under management agreements entered into prior to 1 January 2000. During the year, SNH made payments of £1.4 million under these agreements, which in the absence of European sanction, may be deemed irregular.



8. As agreed the unaudited accounts were provided to us on 30 May 2008, supported by a comprehensive working paper package. The good standard of the supporting papers and the timely responses from SNH staff allowed us to conclude our audit within the agreed timetable and provide our opinion to the Audit and Risk Management Committee on 28 July 2008 as timetabled.

## Financial Position

### Outturn 2007/08

9. SNH is required to work within the resource budget set by the Scottish Government. In 2007/08 SNH stayed within both the cash and non cash elements of its resource budget – see exhibit 1 below.

#### Exhibit 1 – Performance against Resource Budget 2007/08

Resource Allocation (£million)	Budget	Actual Outturn	Difference
Grant in Aid – cash	67.981*	67.371	0.610
Resource cover – non-cash	3.452	3.431	0.021
<b>Total</b>	<b>71.433</b>	<b>70.802</b>	<b>0.631</b>

\* Includes capital receipts budget of £1.236 million

### 2008/09 Budget

10. Scottish Ministers have agreed a resource budget for SNH of £67.182 million for 2008/09. This comprises £63.618 million cash – grant-in-aid, a decrease compared to cash resource available in 2007/08, and £3.564 million to cover non-cash costs.

#### Exhibit 2 – 2008/09 Resource Plan

	TOTAL	'CASH'	'NON CASH'
	£m	£m	£m
Grant in Aid (baseline)	63.618	63.618	0.000
Non cash resource	3.564	0.000	3.564
<b>Resource Budget</b>	<b>67.182</b>	<b>63.618</b>	<b>3.564</b>
Other Income Sources	5.070	5.070	0.000
<b>Total Operating Plan</b>	<b>72.252</b>	<b>68.688</b>	<b>3.564</b>
<b>Analysed as:</b>			
Grant in Aid		63.618	
Other sources		5.070	
<b>'Total Cash'</b>		<b>68.688</b>	
<b>'Non cash' resource</b>		<b>3.564</b>	
<b>Total Operating Plan</b>		<b>72.252</b>	

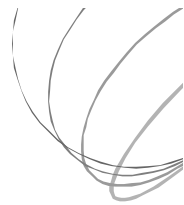




11. SNH is expected to deliver 2% cash-releasing efficiencies from 2008/09 to 2010/11, and this is reflected in the budget agreed with Scottish Ministers. The organisation also faces a number of key financial pressures in 2008/09 including inflation and paybill growth, increased capital and depreciation costs arising from Great Glen House, increased Natural Care costs, and the full costs of the Biodiversity Implementation team.
12. In order to achieve a balanced budget, a programme of planned staff reductions through vacancy management, reviews of asset management, and contract and procurement efficiencies is being put in place in 2008/09 and 2009/10 alongside planned reduction in workstream activity. However there is a risk that the planned staff reductions are not achieved in the financial year.
13. Funding for 2009/10 and 2010/11 has been set at £69.7 million and £71.4 million respectively, however this may be subject to amendment, to reflect the transfer of specific grant funds of around £3.7 million to local authorities. We will continue to monitor the financial position and the actions taken by SNH to manage these risks.

## Issues arising from the audit

14. As required by auditing standards we reported to the Audit and Risk Management Committee on 28 July 2008 the main issues arising from our audit of the financial statements. The key issues reported were:
15. **Regularity qualification on audit opinion:** In 2001, the European Commission confirmed that nature conservation management agreements entered into after 1 January 2000 were allowable as state aid. However, no ruling has yet been made regarding retrospective approval of management agreements entered into prior to 1 January 2000. During 2007/08 SNH spent approximately £1.4 million under pre-January 2000 agreements which, in the absence of European sanction, may be deemed irregular, as in previous years.
16. **Land and property asset indexation:** SNH currently undertake a valuation of land and property assets every five years, and apply an indexation in intervening years. The last formal valuations of land and property were in March 2006 and March 2007 respectively. Indices applied in intervening years are based on Valuation Office Agency property market reports and other recognised indices. However, these indices used do not take account of a range of factors, including the rural nature of some land assets, or current and potential use. The use of unsuitable indices in the revaluation process could lead to significant over or understatement of assets values over time. In 2008/09 and subsequent years, SNH plan to move to a rolling programme of asset valuations, covering a



representative cross-section of assets. This will provide assurance as to the reasonableness of indices used in the indexation process.

## 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 were 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. With the exception of the expenditure referred to in paragraph 15, no significant issues were identified for disclosure.



# Governance

## Overview of arrangements

18. This section sets out our main findings arising from our review of SNH's governance arrangements.

This year we reviewed:

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

19. 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 5-6). Our overall conclusion is that arrangements within SNH are sound and have operated through 2007/08.

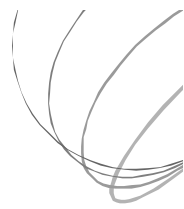
## Strategy

20. In April 2007, SNH introduced a new organisational structure to improve delivery of natural heritage objectives. This included a revised management unit structure, and the introduction of a network of local advisers to replace the previous area boards. A new corporate strategy has been developed, focusing on delivery against the relevant National Outcomes within the Scottish Government's National Performance Framework. The five priorities within the strategy are:

- Caring for nature
- Responding to climate change
- Delivering health and well-being
- Supporting the Scottish economy
- Delivering a high quality public service.

21. To support delivery of the new corporate strategy, a new business planning approach has been put in place, which uses programme management techniques to coordinate contributions across the business units of SNH. These techniques provide a link in measurable terms between the strategy and the Scottish Government's National Performance Framework as well as linking the strategy to individual staff targets.

22. SNH is a member of Scotland's Environmental and Rural Services (SEARS), a partnership designed to deliver streamlined services for rural land managers. Phase 1 of the partnership, launched in June 2008, focuses on:



- a customer focused service, with closer partner working
  - co-ordination of visits and inspections, to minimise duplication across partners
  - a “one door” approach, where any SEARS partner covering a topic can be approached for information
  - consistent and responsive service across SEARS partners, including common and transparent customer care standards.
23. The SEARS project provides SNH and other partners with an opportunity to identify efficiency gains through collaborative working. However, there is also a risk of a disproportionate draw on SNH resources in delivering the new arrangements to land managers, both now and through any future developments. The strategic and operational impact to date on SNH has not been significant, however we will continue to monitor developments in this area during 2008/09.

## **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 his annual report for 2007/08 the head of audit and consultancy services provided his opinion that, based on the internal audit work undertaken during the year, there was reasonable assurance on the adequacy and effectiveness on the systems of internal control. As part of our audit we reviewed the high level controls in a number of SNH systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively.

## **Prevention and detection of fraud and irregularities**

25. SNH has appropriate arrangements in place to prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and Board members.

## **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 2007/08 audit we assessed whether we could place reliance on SNH's internal audit function. We concluded that the internal audit service operates in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in number of areas during 2007/08, as we anticipated in our annual audit plan.



## Statement on Internal Control

27. The Statement on Internal Control provided by SNH'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 SNH's approach to this.

## Information and Communication Technology

28. SNH introduced the first stages of the iPeople HR system in September 2007, with a further rollout in February 2008. The system is designed to improve management information and workflows around HR processes. During the year, there were a number of enhancements to the electronic records document management system, however a number of key areas have still to be implemented, including document scanning, finalising the corporate file plan, and increasing portal access at selected sites. There is a risk that the systems do not achieve the desired benefits. We will monitor the outcomes of the iPeople post implementation review during 2008/09, along with progress in eRDMS.
29. In 2006/07 we undertook a computer services review to assess the key ICT risks SNH face and prioritise areas for review. A number of risk areas were identified in this process, along with planned management action. In 2007/08 we have followed up on this review and are satisfied that SNH are continuing to progress planned actions.



# Performance Management

30. 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.
31. 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.

## Best Value developments

32. The positive impact of the Best Value concept in local government led Scottish Ministers to introduce a non-statutory Best Value duty on all public sector accountable officers (i.e. across health and central government) in 2002. This was reinforced by refreshed Ministerial guidance in 2006, highlighting the importance that the Scottish Government places on Best Value as a means of supporting public service reform.
33. That position was again re-iterated in the Scottish Government's recent response to the Crerar scrutiny review which credited the Best Value regime as a key driver of modernisation and improvement in public services. Audit Scotland is committed to extending the Best Value audit regime across the whole public sector and significant development work has taken place over the last year.
34. The framework for our proposed Best Value audit approach was agreed by Audit Scotland's Corporate Management Team in September 2007. It is based on the key principles of flexibility and proportionality; alignment and integration with our existing activities; being delivered within our existing resources, and with an evolutionary implementation.
35. Using the Scottish Government's nine best value principles as the basis for our audit activity, we have identified five priority development areas (Use of Resources, Governance and Risk Management, Accountability, Review and Option Appraisal, and Joint Working) for our initial development work.
36. Currently we are concentrating on the development of Use of Resources audit toolkits, focusing initially on Financial Management, Efficiency, and Information Management. These toolkits are being piloted in a sample of NHS and central government clients during 2007/08 and 2008/09. Developed toolkits will also be made available to public bodies to consider for self assessment.



37. SNH has continued to embrace Best Value through its development programme, and during the year reviewed and updated the self assessment returns originally prepared in 2006 for the Scottish Government. These self assessments cover all Best Value components and the results have been used to help assess progress within the organisation. In 2008/09 the internal focus in SNH will be on use of resources, performance management, strategic decision making, and financial management. We will review aspects of these arrangements further through the implementation of a financial management toolkit in the autumn, and the rollout of further toolkits through 2008/09.

## Efficiency

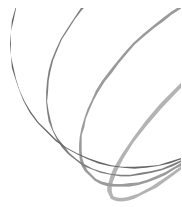
38. Scottish Government set an efficiency target for SNH of £2 million through the Efficient Government Initiative (EGI). This 3 year savings target was exceeded, with efficiencies totalling £2.7 million and the money released used to deliver a range of projects including the launch of the Species Action Framework.
39. In the next three years budget settlement, SNH is required to make 2% per annum cash releasing efficiency savings. This represents an efficiency in the region of £1.3 million per annum. SNH's delivery plan for these efficiencies covers a number of key areas. A review of asset management is currently underway, and has resulted in rationalisation of assets, including the disposal of Hope Terrace. This review is expected to release savings through into 2009/10. Current contract and procurement arrangements will also be reviewed over the coming years to identify areas of potential saving.
40. It is hoped that around £0.7 million of planned efficiencies will come from staff cost savings, through natural wastage and staff turnover. This equates to around 20 FTE posts in 2008/09. There is a risk that the desired reduction in posts cannot be achieved in year, and saving targets will not be met.
41. In order to accommodate the consequential reduction in available staff resource, work priorities are being reviewed to accommodate this drop e.g. by reducing input to non-statutory planning activities, and reducing direct support to local access projects. Other savings will be achieved by scaling back on project input and revising the timescales for delivery. There is a risk that the reduced resourcing of activity streams impacts on the achievement of performance targets for the year.
42. These will be challenging targets for SNH to achieve and we will keep developments in this area under review during 2008/09.



## Performance Management

43. SNH has a number of targets set out in its corporate plan. Nine of these have been agreed as key targets with the Scottish Government. The targets cover four main themes:
- Caring for the natural world
  - Enriching people's lives
  - Promoting sustainable use
  - Delivering the strategy.
44. SNH performed well against its key targets with eight fully achieved and one partially achieved.
45. Key target 2 was to bring 80% of the special features on Scotland's nationally important nature sites into favourable condition by March 2008. This target was not achieved, with 77.5% of features classed as in 'favourable' or 'favourable recovering' condition at 31<sup>st</sup> March 2008. Although this indicator has increased by 6% since April 2005, the number of factors affecting these sites, including the complexities of management arrangements, will make it increasingly difficult for SNH to achieve the target of 95% sites in favourable condition by 2010.
46. Key target 4 was to promote understanding of the Scottish Outdoor Access Code and improve public access to, and enjoyment of, the countryside. This target was measured by increased participation rates. TV advertising campaigns during 2007/08 to raise awareness levels resulted in awareness levels in March 2008 of 67%, the highest ever. The Scottish Recreation Survey yielded data that showed 44% of the adult population in Scotland made at least one trip each week to the outdoors for leisure and recreation purposes the same as last year.
47. Key target 6 relates to increase and secure greater recognition for the contribution of the natural heritage to the rural economy. SNH resourced the activities that underpin this performance measure with 5,000 days of staff time and spend in excess of £12 million on grants and management agreements that have a direct impact on the rural economy. This resulted in 22 publications and 709 press references that highlighted the contribution made to the rural economy by natural heritage.
48. SNH's new corporate plan and strategy include explicit links to the National Performance Framework, and will be used to provide the focus on performance in 2008/09. SNH have been invited by the Scottish Government to provide it's framework as a best practice example. We will consider how SNH is progressing this development as part of the 2008/09 audit.

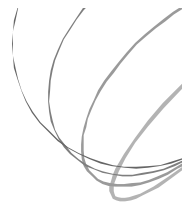




# Looking Forward

49. SNH faces a number of challenges in 2008/09, which include:

- **International Financial Reporting Standards (IFRS)** – As part of the UK Budget 2008 the Chancellor announced that the timetable for IFRS implementation was to be extended by a year with central government accounts in Scotland to become IFRS compliant with effect from the 2009/10 financial year. The Scottish Government have notified central government bodies that they will be required to produce shadow IFRS based accounts for the financial year in 2008/09, including a restated balance sheet as at 1 April 2008. A detailed timetable and list of requirements have been issued by the Scottish Government. This process may require significant resource to complete and it will be important that the restatement is tackled early in 2008/09, with a plan in place to manage the transition.
- **Scotland Performs** – The Scottish Government is continuing to develop its approach to performance management based on a National Performance Framework and outcome agreements. The National Performance Framework is based on the outcome based ‘Virginia-style’ model of performance measurement and reporting. In support of this the Scottish Government has developed a new electronic tool and website to communicate to the public on Scotland’s progress. This will include progress on overall delivery of the administration’s purpose for Government, the five strategic objectives for Scotland and other aspects of the outcomes based National Performance Framework. We will continue to monitor SNH’s contribution towards this development.
- **Efficiency and future funding** – Budgets for 2008/09 and the immediate future will need to be managed within a tighter funding regime. This includes significantly less scope for the application of end of year flexibility for the Government with HM Treasury until the next Spending Review; no option to transfer funds from capital to revenue; and the impact of the introduction of International Financial Reporting Standards (IFRS), particularly on leases and infrastructure accounting. The challenge for SNH is to prioritise spending, identify efficiencies and review future commitments to ensure delivery of key targets and objectives.
- **Data handling** – The Scottish Government carried out a review of data handling arrangements in Scotland, in response to failures in UK government bodies procedures and practices during 2007. The review considered current policies and procedures on data protection, consistency with government standards and local arrangements for implementation of procedures. The final report, published in June 2008, identified good practice across the public sector, and made a number of recommendations for improvement. We will monitor SNH’s response to the review and action taken as part of our 2008/09 audit.



- **Scotland's Environment and Rural Service (SEARS)** - Phase 1 of the project was implemented in June 2008. Although there have been no announcements from Scottish Government yet, it is likely that further phases to this project will be introduced over the coming years. We will continue to monitor developments in this area.
- **Kinloch Castle** – SNH is in discussions with a range of partners about setting up a Trust to take responsibility for the maintenance and day-to-day management of the castle. A number of legal and other issues need to be addressed in relation to these arrangements, including Scottish Government approval of any public sector funding package. We will monitor developments in this area during 2008/09.
- **Deer Commission Scotland** – In April 2008, Scottish Government announced its intention to merge the functions of the Deer Commission for Scotland with SNH. The timetable for this merger will be governed by the progress of the necessary legislation through the planned Public Sector Reform Bill. Subject to the will of Parliament, it is hoped that this will permit the merger to take effect from April 2010. We will monitor this area and liaise with officers on developments during the coming year.