

# Scottish Natural Heritage

2018/19 Annual Audit Report



 AUDIT SCOTLAND

Prepared for Scottish Natural Heritage and the Auditor General for Scotland

29 July 2019

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- the Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- the Accounts Commission is an independent public body appointed by Scottish Ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Key messages

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## 2018/19 annual report and accounts

- 1 The financial statements of Scottish Natural Heritage (SNH) give a true and fair view of the state of its affairs as at 31 March 2019 and of its net expenditure for the year then ended; and have been properly prepared in accordance with the financial reporting framework.
- 2 The expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by Scottish Ministers.
- 3 The audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

## Financial management

- 4 SNH has effective financial management arrangements in place which ensured that it operated within its resource allocation in 2018/19.
- 5 Key controls in core financial systems were operating effectively with the exception of controls over changes to suppliers' bank details and the timely completion of reconciliations. Further audit testing in these areas provided us with sufficient assurance for our audit opinion.

## Financial sustainability

- 6 SNH should develop medium to longer-term financial plans in order to identify and address risks to its financial sustainability and long-term vision for Scotland's nature and landscapes. These plans should link closely to the outcomes set out in its 2018-2022 Corporate Plan.
- 7 SNH had taken reasonable steps, before 29 March 2019 (the original leaving date), to prepare for the impact of EU withdrawal. Internal Audit has reviewed EU exit readiness and concluded that the controls in place to manage this risk are working effectively.

## Governance and transparency

- 8 SNH's governance arrangements support effective oversight of the organisation's activities and finances.
- 9 Internal audit has proposed a number of improvements to arrangements for openness and transparency including publishing Board papers proactively on SNH's website.

## Value for money

- 10 SNH has a well-developed performance management framework. The majority (88%) of SNH's key deliverables had been completed or were on track as at 31 March 2019.

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# Introduction

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1. This report summarises the findings from our 2018/19 audit of Scottish Natural Heritage (SNH).

2. The scope of our audit was set out in our Annual Audit Plan presented to the February 2019 meeting of the Audit and Risk Committee. This report comprises the findings from:

- an audit of the SNH's annual report and accounts
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

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## Exhibit 1 Audit dimensions



Source: Code of Audit Practice 2016

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

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

## Adding value through the audit

4. We add value to SNH through the audit by:

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

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

## Responsibilities and reporting

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

- performance report
- accountability report (which includes the corporate governance report, remuneration and staff report and parliamentary and accountability report)
- financial statements and supporting notes.

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

8. Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), and supplementary guidance and International Standards on Auditing in the UK.

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

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

10. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**11.** This report raises matters from the audit of the annual report and accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

**12.** Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, responsible officers and dates for implementation. It also includes any outstanding actions from last year and progress against these.

**13.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services. The 2018/19 audit fee of £56,980 set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

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

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

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# Part 1

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## Audit of 2018/19 annual report and accounts

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### Main judgements

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**The financial statements of SNH give a true and fair view of the state of its affairs as at 31 March 2019 and of its net expenditure for the year then ended; and have been properly prepared in accordance with the financial reporting framework.**

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**The expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.**

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**The audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.**

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

### Audit opinions on the annual report and accounts

**16.** The annual report and accounts for the year ended 31 March 2019 were approved by the Audit and Risk Committee on 29 July 2019. We reported within the independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared
- expenditure and income were regular and in accordance with applicable enactments and guidance issued by Scottish Ministers
- the audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

**17.** Additionally, we have nothing to report in respect of misstatements in other information presented with the financial statements, the adequacy of accounting records or the information and explanations we received.

## Submission of annual report and accounts for audit

**18.** We received the unaudited annual report and accounts on 31 May 2019, in line with our agreed audit timetable, but these were incomplete as they did not include the impact of the revaluation of non-current assets as at 31 March 2019 (which impacts on all of the key financial statements and a number of the notes) and a number of other disclosure notes. A complete annual report and accounts was not received until 27 June.

**19.** The delay impacted on our resource plan resulting in additional pressure on the audit team and SNH finance staff later in the process. Whilst we appreciate that 2018/19 was an exceptional year for finance staff with the introduction of the new HR and finance system happening at the same time as the five year revaluation of all property and infrastructure assets, our audit planning is based on the expectation that we will receive a complete set of accounts and working papers by the agreed date. Where this does not happen, a supplementary fee may be charged. Following assurances from senior management that a complete annual report and accounts will be submitted for audit next year, I have agreed not to charge an additional fee this year.

**20.** The working papers provided with the unaudited financial statements were of a high standard and finance staff provided good support to the audit team which helped ensure the final accounts audit process ran relatively smoothly despite the delays noted above.

## Risk of material misstatement

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

## Materiality

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

**23.** Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit and is summarised in [Exhibit 2](#). With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively. On receipt of the unaudited annual report and accounts we reviewed our materiality calculations and concluded that they remained appropriate.

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## Exhibit 2 Materiality values

Materiality level	Amount
Overall materiality	£546,000
Performance materiality	£410,000
Reporting threshold	£30,000

Source: Scottish Natural Heritage Annual Audit Plan 2018/19

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

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

**25.** The significant findings are summarised in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1](#) has been included.

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### Exhibit 3

#### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Non-current asset revaluation</b></p> <p>As noted above, the annual report and accounts submitted for audit did not include the disclosures required to reflect the revaluation of non-current assets due to unexpected technical delays in calculating these. As a result, net expenditure and total comprehensive expenditure were overstated by £122,000 and £1.6 million respectively in the unaudited Statement of Comprehensive Net Expenditure (refer to paragraphs 18 and 19 above). In the Statement of Financial Position, non-current assets, the general reserve and the revaluation reserve were understated by £1.6 million, £0.3 million and £1.3 million respectively.</p>	<p>The audited financial statements have been amended to reflect these omissions.</p>
<p><b>2. Misclassification of income</b></p> <p>Staff costs, income from activities and external income were understated by £102,000, £16,000 and £86,000 respectively in the Statement of Comprehensive Net Expenditure due to the miscoding of income transactions.</p>	<p>The audited financial statements have been amended to reflect this misstatement. There is no impact on reserves.</p>

Source: Audit Scotland

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### How we evaluate misstatements

**26.** There was one material adjustment (£1.6 million) to the annual report and accounts submitted for audit due to the revaluation of non-current assets. As this adjustment reflects the full extent of the revaluation of non-current assets charged to the revaluation reserve, further audit procedures were not required.

**27.** It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected although the final decision on making the correction lies with those charged with governance. Senior finance officers agreed to amend the financial statements for all of the presentational and monetary misstatements identified during the audit and so there are no unadjusted misstatements to bring to the attention of those charged with governance.

**28.** The net effect of the adjustments processed was to decrease net expenditure by £122,000, increase gains on the revaluation of property, plant and equipment by £1.5 million and increase net assets by £1.6 million. In addition to the findings set out in [Exhibit 3](#), adjustments were also made to correct the use of provisions, and to recognise a late accrual of a management agreement.

## Finance team capacity

**29.** As noted above, 2018/19 was an exceptional year for finance staff with the introduction of the new HR and finance system happening at the same time as the five-year revaluation of all property and infrastructure assets.

**30.** The introduction of the new integrated finance and HR system (FUSION) was delayed from the planned date of 1 April 2019 due to issues with data migration. A phased implementation was undertaken with finance, expenses and some elements of the HR system going live in June 2019. Payroll and other HR functions are due to go live in July 2019. The implementation of FUSION impacted on the capacity of the finance team to maintain normal oversight of key areas during 2018/19. This, together with unexpected delays relating to the quinquennial revaluation of non-current assets, meant slippage occurred during the preparation of the financial statements which in turn contributed to the delay in providing a complete annual report and accounts to the audit team.

**31.** In our 2018/19 management report we reported delays in the completion of key reconciliations. As part of our financial statements audit, we reviewed these reconciliations for the remainder of the year and noted that the accounts payable and accounts receivable control account reconciliations for January 2019 were not prepared and reviewed until March 2019. We raised a similar point in our 2017/18 management report. The timely completion of reconciliations is key to ensuring that fraudulent or erroneous transactions are promptly detected.



### Recommendation 1

**SNH should review the capacity of its finance team to ensure that it is sufficient to meet its needs.**

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# Part 2

## Financial management



### Main judgements

SNH has effective financial management arrangements in place which ensured that it operated within its resource allocation for 2018/19.

Key controls in core financial systems were operating effectively with the exception of controls over changes to suppliers' bank details and the timely completion of reconciliations. Further audit testing in these areas provided us with sufficient assurance for our audit opinion.

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

### Financial performance in 2018/19

**32.** The main financial objective for SNH is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

**33.** SNH's performance against Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME) is shown in [Exhibit 4](#). Scottish Natural Heritage reported an outturn of £52.872 million, underspending its overall DEL budget for 2018/19 by £1.641 million.

### Exhibit 4 Performance against DEL and AME in 2018/19

Performance	Initial budget £'000	Final budget £'000	Outturn £'000	Over (under) spend £'000
Resource DEL	45,627	53,633	51,988	(1,645)
Capital DEL	880	880	884	4
<b>Total DEL</b>	46,507	54,513	52,872	(1,641)
Annually managed expenditure (AME)	-	158	(174)	(332)
<b>Total Allocation</b>	46,507	54,671	52,698	(1,973)

Source: Scottish Government Budget and Spring Budget Revision 2018/19 and Scottish Natural Heritage Annual Report and Accounts 2018/19

## Budget underspend agreed with the Scottish Government

**34.** During 2018/19, SNH agreed with the Scottish Government that it would underspend its budget by £143,000. The £1.6 million underspend above includes this authorised underspend as the budget allocation was not adjusted by the Scottish Government. Once the agreed underspend is taken into account, SNH underspent its DEL by £1.5 million. As in previous years, the majority of this underspend relates to delays in progressing the peatland restoration project due to weather related days and contractor availability.

## 2018/19 financial position

**35.** The Statement of Financial Position summarises what is owned and owed by SNH. This shows that SNH had net assets of £25.9 million as at 31 March 2019, an increase of £1.4 million from the prior year. The majority of this increase relates to property, plant and equipment (£0.9 million).

## Budgetary processes

**36.** We reviewed SNH's budget setting and monitoring arrangements, including monitoring reports presented to the Board, and concluded that appropriate budget setting and monitoring arrangements are in place.

**37.** During the year, a number of amendments were made to the 2018/19 budget due to increases in funding provided by the Scottish Government. These included an additional £8.4 million to fund peatland restoration, £1.1 million for various other initiatives, and the surrender of £1.5 million to support Scotland's Rural Development Programme.

## Systems of internal control

**38.** As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to confirm that the controls are operating as expected and that SNH's systems for recording and processing transactions provide a sound basis for the preparation of the financial statements.

**39.** The findings from our review of systems of internal controls were included in the management report presented to the Audit and Risk Committee on 15 May 2019. We concluded that the key controls tested were operating effectively with the exception of controls in operation over changes to suppliers' bank details and the timely completion of reconciliations. As part of the financial statements audit, we extended our substantive testing of these areas to obtain additional assurances for our opinion on the annual accounts (see paragraph 31 for details).

**40.** No significant internal control weaknesses were identified during the audit which could affect SNH's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

## Internal audit

**41.** We reviewed SNH's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent to which we could use of the work of internal audit. While we chose not to place formal reliance on the work of internal audit, we did consider several of its reviews - risk management system, EU exit readiness and the openness and transparency review – to support our wider dimension audit responsibilities. Internal audit is provided by SNH's in-house internal audit team supported by a co-sourcing contract with BDO to provide specialist and additional resources as required.

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

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

**43.** We have reviewed the arrangements in place to maintain standards of conduct including the Staff Code of Conduct and Board Members Code of Conduct and confirmed that there are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

**44.** We have concluded that SNH has appropriate arrangements in place for the prevention and detection of fraud, error and irregularities, bribery and corruption. We are not aware of any specific issues that we need to bring to your attention.

## National Fraud Initiative

**45.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.

**46.** NFI activity is summarised in [Exhibit 5](#). The application records a total of 746 matches. It is up to individual bodies to decide which, and how many, matches to investigate and the online application identifies high risk cases. In SNH's case the application has identified 1 high risk match. To date, SNH has investigated 86 matches. No frauds or errors have been found so far.

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### Exhibit 5 NFI activity



746

Matches



1

High risk matches



86

Completed/closed  
investigations

Source: NFI secure website: [www.nfi.gov.uk](http://www.nfi.gov.uk)

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## Good practice

**47.** SNH requires all Board members to update their register of interests on a regular basis. Quarterly reminders are sent to ensure interests are reviewed and updated. In addition, all staff are required to review and update register of interests annually or as soon as changes have occurred. This enables early identification of any circumstance which may pose the potential for a conflict of interest. We consider that these arrangements represent good practice as all Board members, directors and staff are included in the process. The [Code of Audit Practice 2016](#) encourages auditors to identify good practice which in their opinion is worth sharing more widely.

# Part 3

## Financial sustainability



### Main judgements

**SNH should develop medium to longer-term financial plans in order to identify and address risks to its financial sustainability and long-term vision for Scotland's nature and landscapes. These plans should link closely to the outcomes set out in its 2018-2022 Corporate Plan**

**SNH had taken reasonable steps, before 29 March 2019 (the original leaving date), to prepare for the impact of EU withdrawal. Internal Audit has reviewed EU exit readiness and concluded that the controls in place to manage this risk are working effectively.**

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

### Financial planning

**48.** The 2019/20 budget setting process began in August 2018 with the Board's consideration of its strategic priorities for the coming year. The Board approved the 2019/20 budget in March 2019 as part of the 2019/20 Business Plan which shows SNH plans to invest £70 million in nature during 2019/20. This will be funded by £46.5 million grant in aid from the Scottish Government (2017/18 £46.5 million) and additional funding for specific strategic projects.

**49.** As part of the 2019/20 budget setting process, scenario planning (ranging from flat cash to a 20% reduction in baseline budget) was undertaken to model the potential implications for ongoing work but this was only done for one year. As noted above, a flat cash settlement was subsequently received from the Scottish Government. SNH recognises that the 2019/20 budget will be challenging to deliver and will closely monitor expenditure during the coming year.

**50.** The budget incorporates a number of budgetary pressures including an increase in the amount allocated for pay bill costs, and the impact of increased employer contributions to the Civil Service pension scheme (estimated at £1.4 million). At the time of setting the budget, there was uncertainty about how much additional funding would be provided to fund this increase. Additional funding of £1 million was subsequently received from the UK government.

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

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

**52.** The Scottish Parliament has introduced a new budget process which is based on a year-round continuous cycle of budget setting, scrutiny and evaluation. As part of the new budget process, the Scottish Government published an initial five-year Medium-Term Financial Strategy (MTFS) in May 2018. The five-year outlook for the Scottish budget, set out in the MTFS, provides useful context for bodies' financial planning.

**53.** Last year we recommended that SNH continue to develop its financial planning models in order to identify and address risks to financial sustainability across the medium (two to five years) and longer (five to ten years) term. Limited progress was made on this during 2018/19 with the 2019/20 budget covering a one-year period.

**54.** SNH has recognised that further work is required on medium and longer-term financial planning. The six biggest areas of project spend have been identified (accounting for 80% of this expenditure) and these will be reviewed in detail over the coming months to identify opportunities to better target expenditure at what contributes most to delivery of the corporate plan priorities. Tough decisions will need to be taken during the coming year in order to get these areas on to a more manageable and sustainable basis.

**55.** Staff costs continue to be the biggest area of expenditure accounting for 57% of Grant in Aid funding in 2019/20. The Senior Leadership Team has agreed to continue the existing approach to vacancy management, reducing pay bill costs through a combination of temporary and permanent savings, with only 20% of vacancies being filled.

**56.** The 2018-2022 Corporate Plan acknowledges that SNH will need to transform the way it works if it is to deliver its long-term vision for Scotland's nature and landscapes. Medium and longer-term financial planning will be key to the organisation understanding the impact of proposed changes and its capacity to take on new challenges and initiatives.



## Recommendation 2

**SNH should develop medium to longer-term financial plans in order to identify and address risks to its financial sustainability and long-term vision for Scotland's nature and landscapes. These plans should link closely to the outcomes set out in its 2018-2022 Corporate Plan.**

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## EU Withdrawal

**57.** European Union (EU) withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies, and so it is critical that public sector bodies understand, assess and prepare for the likely impact on their business.

**58.** As part of our interim audit we undertook a high-level review of SNH's preparedness for EU withdrawal focusing on three key areas: people, regulations and funding. We reported our findings in our 2018/19 Management Report and concluded that SNH had taken reasonable steps, before 29 March 2019 (the original leaving date), to prepare for the impact of EU withdrawal.

**59.** Since then, Internal Audit has completed a review of SNH's EU exit readiness and concluded that the controls put in place to manage the risk of inadequate preparation for EU Exit are working effectively. Two areas were identified where the arrangements could be further improved, and an action plan was agreed to address these. At the date of writing this report, there remains great uncertainty regarding the terms of the UK's withdrawal from the EU.

## Follow up of prior year recommendations

**60.** We reviewed progress made in implementing the agreed action included in our 2017/18 annual audit report. We concluded that SNH has made limited progress in developing medium to longer-term financial planning during 2018/19 and have included a revised recommendation in [Appendix 1](#).

# Part 4

## Governance and transparency



### Main judgements

**SNH's governance arrangements support effective oversight of the organisation's activities and finances.**

**Internal audit has proposed a number of improvements to arrangements for openness and transparency including publishing Board papers proactively on SNH's website.**

Governance and transparency are concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.

### Governance arrangements

- 61.** SNH's corporate governance framework is centred around the Board which is supported by three committees: the Audit and Risk Committee, Protected Areas Committee and Scientific Advisory Committee.
- 62.** In our Annual Audit Plan, we noted that the appointments of eight of the nine Board members were due to end on 31 March 2019 and that there was a risk that significant changes in Board membership would impact on the effectiveness of governance and scrutiny arrangements whilst new Board members became familiar with SNH's business. All eight Board members were re-appointed in March 2019. Three were appointed for a further two years, with the remainder appointed until 31 March 2022.
- 63.** Board members are committed to personal development and are well supported by staff within the Executive Office. Based on our attendance at Audit and Risk Committee meetings and review of Board agendas and papers, we concluded that Scottish Natural Heritage has appropriate arrangements in place that support good governance, accountability and scrutiny.

### Openness and transparency

- 64.** There is an increasing focus on how public money is used and what is achieved. In that regard, openness and transparency supports understanding and scrutiny. Transparency means that the public has access to understandable, relevant and timely information about how the Board is taking decisions and how it is using resources such as money, people and assets.
- 65.** In previous annual audit reports we have commented that there was scope for SNH to improve its openness and transparency. In May 2018, Audit Scotland published guidance for auditors to consider when reviewing an organisation's approach to openness and transparency. We shared this guidance with SNH and, following review by the Audit and Risk Committee, Internal Audit were asked to review SNH's approach to the openness and transparency of Board decision-making and the publication of information on its website.

**66.** The Internal Audit review identified a number of areas of good practice in relation to the publication of information relating to the Board and sub-committees on SNH's website and concluded that SNH compared favourably to the other central government websites that had been reviewed. The review also included a number of proposed changes to improve the existing arrangements for consideration by the Board. These included:

- bringing the Board “higher up” the SNH website i.e. making it more accessible from the home page
- making open session Board papers proactively available on the website (note: there will always be papers that will require to be considered in closed session because they contain sensitive information)
- producing a short “Guide to Open Meetings” so that readers do not have to go through the detailed and sometimes technical Standing Orders
- having a short section on openness of decision-making within sub-committee terms of reference, summarising what information will be made publicly available for each sub-committee
- ensuring a consistent webpage format/set-up across all 3 sub-committees.

**67.** In addition, Executive Office staff have been tasked with undertaking an Equality Impact Assessment of Board meetings and the accessibility of open papers, and to bring proposals to the Board. Two key roles are also being refreshed/established in 2019 to help ensure material published on SNH's website is fit for purpose.

**68.** While it is for each organisation to determine what papers are made available, we are of the view that Board and sub-committee papers should be published on SNH's website unless they contain confidential or sensitive information.

## Performance report

**69.** The purpose of a performance report is to provide information on a body, its main objectives and strategies, and the principal risks that it faces. It is required to provide a fair, balanced and understandable analysis of performance and, is essential in helping stakeholders understand the financial statements.

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

**71.** Following review by audit, a number of amendments were made to the performance report to improve its balance and understandability. We concluded that the audited performance report met the requirements of the FReM and noted that it included good use of diagrams and infographics.

## Cyber security

**72.** The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017. This requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate. Last year we reported that SNH intended to attain Cyber Essentials Plus accreditation by 31 March 2019 and this was achieved in November 2018.

**73.** We also reported that an assessment of compliance against the information security standard (ISO 27001) was planned during 2018/19. An external assessment has recently been completed with a paper scheduled to be considered by the Audit and Risk Committee in August 2019.

# Part 5

## Value for money



### Main judgements

**SNH has a well-developed performance management framework. The majority (88%) of SNH's key deliverables had been completed or were on track as at 31 March 2019.**

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

### Best value

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

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

**76.** The Chief Executive of SNH is the designated Accountable Officer. The annual report and accounts sets out a range of processes that help the Accountable Officer demonstrate best value:

- SNH's corporate plan and business plan, which clearly articulate its commitments, leadership role and how it manages its resources
- performance management – performance is tracked throughout the year and reported quarterly to the Senior Leadership Team and Board
- SNH's governance and accountability, reflected in its management structure, policies and leadership, which set out clear lines of responsibility and reporting, as well as the robust systems used for decision-making, budget and risk management
- how SNH manages its resources – undertaking reviews of fixed assets, maximising efficiencies for procurement of goods and services, and making the best use of its people
- SNH's approach to partnership working, which underpins much of what it does, including building positive, mutually beneficial relationships with many other bodies
- building sustainability into how it operates – through procurement practice, the greening of its offices, sharing accommodation with other organisations, and its approach to travel and how it uses energy.

## Performance management

**77.** SNH's latest four-year corporate plan 'Connecting People and Nature', published in March 2018, sets out the Board's vision for Scotland's nature and landscapes and is built around four interdependent outcomes:

- more people across Scotland are enjoying and benefiting from nature
- the health and resilience of Scotland's nature is improved
- there is more investment in Scotland's natural capital and its management to improve prosperity and wellbeing.
- we have transformed how we work.

**78.** The corporate plan is supported by the 2018/19 business plan 'Making Connections: Year 1' which sets out the Board's 21 key commitments for 2018/19 and how these will contribute to delivery of the corporate plan's outcomes. Performance against these commitments and the 50 key deliverables which support them is monitored quarterly by the Board. Performance against the Scottish Government's national performance framework indicators that SNH leads or contributes to is also reported.

**79.** Performance reports use a traffic light system to report progress against each of the commitments and key deliverables. The 2018/19 quarter 4 performance report highlights that, as at 31 March 2019, 18 of the key commitments were on track with minor slippage on the remaining three. 88% (44) of the 50 key deliverables had been completed/were on track, 5 were showing some minor slippage and 1 (delivering favourable conditions on protected nature sites) had slipped significantly from planned progress. Plans are in place to recover this slippage in 2019/20.

**80.** Board members also receive supplementary reports on specific aspects of performance such as people management and financial performance against budget which enables them to focus on areas of key risk.

**81.** We concluded that SNH has a well-developed performance management framework in place.

## National performance audit reports

**82.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Although there were no reports published in 2018/19 which were of direct interest to SNH, there were others with some wider relevance. These are outlined in [Appendix 3](#).

**83.** The Scottish Public Finance Manual requires that the Accountable Officer formally considers a proportionate response to relevant national reports issued by Audit Scotland. In order to meet this requirement, the Head of Internal Audit and the Head of Finance, Planning and Performance summarise relevant Audit Scotland reports and bulletins and prepare a response for the Accountable Officer to consider and comment on. These summaries are also circulated to relevant officers and presented on a quarterly basis to the Audit and Risk Committee.

# Appendix 1

## Action plan 2018/19



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Finance team capacity</b></p> <p>During the 2018/19 we identified areas where resource pressures had led to slippage in key finance tasks including completion of reconciliations. In addition, the annual report and accounts submitted for audit was incomplete and a complete version was not received until 27 June, nearly four weeks after the agreed submission date.</p> <p><b>Risk</b></p> <p>There is a risk that SNH does not have sufficient financial capacity to meet its needs.</p>	<p>SNH should review the capacity of its finance team to ensure that it is sufficient to meet its needs.</p>	<p>A review of posts within the finance function is ongoing as part of a wider resource mapping exercise across SNH.</p> <p><b>Responsible officer:</b></p> <p>Head of Finance, Planning and Performance</p> <p><b>Agreed date:</b> December 2019</p>
2	<p><b>Financial Sustainability</b></p> <p>SNH's financial plans only cover a one-year period. Last year we reported that the publication of the Scottish Government's five-year financial strategy, together with SNH's new 2018-2022 Corporate Plan, provided an opportunity to further develop medium and longer-term financial planning.</p> <p>Limited progress was made on this during 2018/19 with the 2019/20 budget covering a one-year period. Scenario planning was used as part of the 2019/20 budget setting process, but this only covered one year.</p> <p><b>Risk</b></p> <p>SNH is unable to deliver on its long-term vision for Scotland's nature and landscapes.</p>	<p>SNH should develop medium to longer-term financial plans in order to identify and address risks to its financial sustainability and long-term vision for Scotland's nature and landscapes. These plans should link closely to the outcomes set out in its 2018-2022 Corporate Plan.</p>	<p>SNH will continue to prioritise this area of work. Work is underway to create a medium to longer-term plan including payroll which is being modelled on a rolling three-year basis.</p> <p><b>Responsible officer:</b></p> <p>Head of Finance, Planning and Performance</p> <p><b>Agreed date:</b> December 2019</p>

# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating to our wider responsibility under the [Code of Audit Practice 2016](#).

Audit Risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>Our audit work did not identify any issues that would indicate management override of controls affecting the year end position.</p>
<p><b>2 Risk of fraud over expenditure</b></p> <p>Most public-sector bodies are net expenditure bodies and, therefore, the risk of fraud is more likely to occur in expenditure. SNH makes significant grant payments to third parties. Due to the nature of this expenditure there is an inherent risk of fraud over expenditure.</p>	<p>Walk-through of controls over payables, covering grant expenditure.</p> <p>Substantive testing of expenditure transactions including focused testing of grant payments to third parties.</p> <p>Review action taken to investigate and clear data matches resulting from the NFI exercise.</p>	<p>Our controls work did not identify any issues with the system for the processing or payment of trade payables which encompasses grant payment transactions.</p> <p>Our substantive testing of grant expenditure did not identify any issues.</p> <p>To date, SNH has investigated 86 NFI matches. No frauds or errors have been found so far.</p>
<p><b>3 Estimations and Judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of non-current assets and accruals. This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Reliance on the work of an expert to support the quality of data provided by valuers.</p> <p>Substantive testing of transactions in 2018/19.</p>	<p>We reviewed the valuations of land and property which were prepared by management's experts (District Valuation Office). We found these judgements to be sound and, as such, could place reliance on the experts' work.</p> <p>Our substantive testing of accruals did not identify any issues.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p><b>4 HR and finance systems upgrade</b></p> <p>Plans are in place to upgrade the current Oracle finance system to a cloud-based version with effect from 1 April 2019. The current version has been customised to provide a range of reports for final accounts and audit purposes including those required for cut-off testing. There is a risk that additional work will be required to generate similar reports from the new system, and this may impact on the ability to deliver the accounts and audit within the agreed timescales.</p>	<p>Liaise with key financial staff and request key reports required for audit purposes prior to 1 April 2019.</p> <p>Substantive testing of year end transactions to confirm they have been accounted for in the correct financial year (cut-off testing).</p>	<p>The new system did not go live until June 2019 due the extension of the user acceptance testing for the HR system.</p> <p>Our substantive testing of year end transactions did not identify any issues with cut-off.</p>

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

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<p><b>5 Board membership</b></p> <p>The appointments of eight of the nine current Board members are due to end on 31 March 2019. There is a risk that significant changes in Board membership will impact on the effectiveness of governance and scrutiny arrangements while new Board members become familiar with SNH's business.</p>	<p>Monitor public appointments website for new appointments to the Board.</p> <p>Assess governance and scrutiny arrangements and report conclusions in the Annual Audit Report.</p>	<p>All eight Board members were re-appointed in March 2019. Three were appointed for a further two years, with the remainder appointed until 31 March 2022.</p> <p>Refer to paragraphs 61 to 63 where we conclude that SNH has appropriate arrangements in place that support good governance, accountability and scrutiny.</p>
<p><b>6 Financial Sustainability</b></p> <p>Fewer than anticipated staff left SNH during the first seven months of 2018/19 and as a result £400,000 was transferred from the projects budget to the pay bill budget to fund the projected overspend. There is a risk that the current vacancy management policy does not reduce future years' pay bills to a sustainable level resulting in reduced projects budgets which will impact on the delivery of the strategic outcomes set out in the 2018-2022 Corporate Plan.</p>	<p>Review of 2018/19 outturn against budget.</p> <p>Review of 2019/20 budget setting process.</p> <p>Review of medium- and long-term financial plans including scenario planning and impact of the Scottish Government's five-year financial strategy.</p>	<p>SNH operated within its resource allocation in 2018/19 (refer to paragraph 33).</p> <p>The 2019/20 budget contains a number of budgetary pressures and will be challenging to deliver (refer to paragraphs 48 to 50)</p> <p>Limited progress was made with the development of medium and longer-term financial planning during 2018/19. Scenario planning was used in the development of the 2019/20 budget, but this was only for the one year. SNH has recognised that further work is required in this area and that tough decisions will need to be taken during the coming year in order to get spend on to a more manageable and sustainable basis (refer to paragraphs 51 to 56).</p>

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Audit Risk	Assurance procedure	Results and conclusions
<p><b>7 European Union (EU) withdrawal</b></p> <p>The UK's decision to leave the EU on 29 March 2019 represents a major constitutional change for Scotland. It will affect everyone in Scotland to some degree including SNH. What these effects will be remains uncertain, but they will unfold over both the short and the long term. There is a risk that withdrawal from the EU adversely affects SNH's business.</p>	<p>Review of Audit and Risk Committee/Board papers.</p> <p>Assess Scottish Natural Heritage's preparations for EU withdrawal through discussions with EU co-ordinator and report, as appropriate, in the Annual Audit Report.</p>	<p>We reviewed SNH's preparations for EU withdrawal and concluded that it had taken reasonable steps, before 29 March 2019 (the original leaving date), to prepare for the impact of EU withdrawal.</p> <p>We also reviewed Internal Audit's report on EU exit readiness. (refer to paragraphs 57 to 59).</p>

# Appendix 3

## Summary of national performance reports 2018/19

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

### Central Government relevant reports

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

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

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

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

# Scottish Natural Heritage

## 2018/19 Annual Audit Report

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