

# Scottish Natural Heritage

2019/20 Annual Audit Report



 AUDIT SCOTLAND

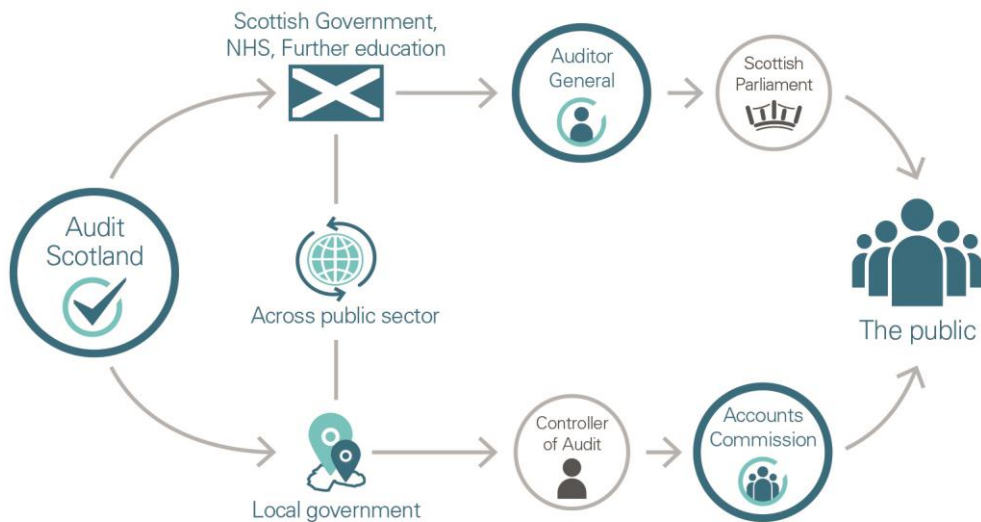
Prepared for the Scottish Natural Heritage and the Auditor General for Scotland

29 July 2020

## 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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## 2019/20 annual report and accounts

- 1 SNH's financial statements give a true and fair view of the state of its affairs as at 31 March 2020 and of its net expenditure for the year.
- 2 The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.
- 3 The other information in the annual report and accounts is consistent with the financial statements and was prepared in accordance with legal requirements.
- 4 An 'Emphasis of Matter' paragraph is included in the independent auditor's report to draw attention to the impact of Covid-19 on property valuations. The audit opinion is not modified in respect of this matter.

## Financial management

- 5 SNH has effective financial management arrangements which enabled it to operate within its resource allocation in 2019/20.
- 6 Key controls in core financial systems operated effectively during 2019/20.
- 7 Appropriate arrangements are in place for the prevention and detection of fraud and corruption.

## Financial sustainability

- 8 SNH is updating its 2020/21 business plan to reflect the impact of Covid-19. It is anticipated that SNH will be asked to support the Scottish Government with its long-term recovery plans although the implications of this on future funding is not yet known.
- 9 SNH has yet to develop a medium or longer-term financial plan.

## Governance and transparency

- 10 SNH had appropriate governance arrangements in place during 2019/20. It has made changes to its operating environment and governance arrangements in response to the impact of Covid-19.
- 11 The performance report included in the audited annual report and accounts meets the requirements of the Financial Reporting Manual (FReM) with scope for further improvement.

## Value for money

- 12 SNH has an appropriate best value framework in place.
- 13 A well-developed performance management framework is in place. 75% of key deliverables were achieved or on track by the year-end.

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# Introduction

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1. This report summarises the findings from our 2019/20 audit of Scottish Natural Heritage (SNH).
2. The scope of our audit was set out in our Annual Audit Plan presented to the February 2020 meeting of the Audit and Risk Committee. This report comprises the findings from:
  - an audit of 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 2019/20 have been:
  - a review of SNH's key financial systems
  - an audit of SNH's 2019/20 annual report and accounts including issue of an independent auditor's report setting out my opinions
  - consideration of the four audit dimensions.

**4.** In common with all organisations, SNH has had to respond to the global coronavirus (Covid-19) pandemic. This affected the final month of the 2019/20 financial year and will continue to have significant impact in 2020/21 due to the closure of visitor centres and suspension of outdoor activities.

**5.** As we undertook our audit planning work prior to the pandemic, we reviewed our assessment of audit risks and the planned audit work in May 2020 and concluded that they remained relevant. As part of our 2019/20 audit, we planned to review how SNH demonstrates compliance with the Equality Act 2010, and how it is advancing equalities within and outwith the organisation. Due to the impact of Covid-19 on audit resources, we will complete and report this work as part of our 2020/21 audit.

## Adding value through the audit

**6.** We add value to SNH through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvement
- 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.

## Responsibilities and reporting

**7.** 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 accounts' direction from the Scottish Ministers.

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

**9.** 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. 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.

Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**10.** This report raises matters from our 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.

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

## **Auditor independence**

**12.** Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

**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 2019/20 audit fee of £57,730 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 SNH 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 the management and staff who have been involved in our work for their cooperation and assistance during the audit, particularly given the current challenges presented by the impact of Covid-19.

# Part 1

## Audit of 2019/20 annual report and accounts



### Main judgements

**SNH's financial statements give a true and fair view of the state of its affairs as at 31 March 2020 and of its net expenditure for the year then ended; and have been properly prepared in accordance with the financial reporting framework.**

**The expenditure and income in the financial statements were incurred or applied in accordance with the applicable enactments and guidance.**

**The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.**

**An 'Emphasis of Matter' paragraph is included in the independent auditor's report to draw attention to the impact of Covid-19 on property valuations. The audit opinion is not modified in respect of this matter.**

The annual report and accounts are the principal means of accounting for the stewardship of resources and performance.

### Our audit opinions on the annual report and accounts are unmodified

**16.** The annual report and accounts for the year ended 31 March 2020 were approved by the Audit and Risk Committee on 29 July 2020. We reported within the independent auditor's report that:

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

**17.** We have included an 'Emphasis of Matter' paragraph in our independent auditor's report which refers to the impact of Covid-19 on the valuations of land and buildings. Emphasis of Matter paragraphs are added to auditors' reports where the auditor considers it necessary to draw users' attention to matters which are fundamental to the understanding of the accounts. Note 2.19' (Accounting estimates and assumptions) and Note 15 (Property, plant and equipment) in the financial statements describe the uncertainty caused. The audit opinion is not modified in respect of this matter. Further information is contained in [Exhibit 3](#) below.



**18.** In accordance with the Whole of Government Accounts (WGA) guidance we aim to complete the required assurance statement for submission to the National Audit Office (NAO). We await confirmation of the revised deadline for completion but understand that this will be 30 November at the earliest.

### The annual report and accounts were signed off within the original timescales

**19.** The unaudited annual report and accounts were received, on 29 May 2020, in line with our agreed audit timetable. Both SNH and Audit Scotland staff worked from home for the duration of the audit due to the Covid-19 pandemic and this presented challenges for both the finance and audit teams. As a result, the audit took longer than normal to complete.

**20.** The unaudited annual report and accounts and supporting working papers were of a good standard and the audit team received good support from the finance team. Remote working meant that some elements of the accounts and some supporting working papers were not provided at the start of the audit. This did not unduly impact the audit process but did mean finance staff had to juggle answering audit queries with completing outstanding tasks.

**21.** Regular communication and good working relationships between the finance and audit teams helped ensure the audit ran smoothly and, despite the challenges of lockdown, we were able to complete the audit on 29 July 2020 as set out in our annual audit plan.

### Overall materiality is £0.595 million

**22.** The assessment of what is material is a matter of professional judgement. It involves considering both the amount and the nature of a misstatement in the financial statements.

**23.** On receipt of the unaudited annual report and accounts we reviewed our materiality calculations and updated them as set out in [Exhibit 2](#).

## Exhibit 2 Materiality values

Materiality level	Amount
Overall materiality	£595,000
Performance materiality	£355,000
Reporting threshold	£30,000

Source: Audit Scotland

### Our work to address the main risks of material misstatement is set out in Appendix 2 with key findings reported in Exhibit 3

**24.** [Appendix 2](#) provides our assessment of risks of material misstatement in the annual report and accounts and any wider audit dimension risks. These risks influence our overall audit strategy, the allocation of staff resources to the audit and indicate how the audit team was directed. The appendix identifies the work we undertook to address these risks and our conclusions from this work.

**25.** We undertook our planning work and issued our 2019/20 annual audit plan in February 2020, prior to the Covid-19 pandemic. In line with auditing standards and professional advice, including the [Financial Reporting Council's Covid-19 bulletin](#) published in March 2020, we reviewed our assessment of audit risks and the planned audit work in May 2020 and concluded that they remained relevant. There have not been any changes to audit risks, our audit approach or the timing of our audit.

**26.** Matters arising from our work on the risks of material misstatement include risks relating to management judgement and estimation and are discussed further in [Exhibit 3](#) below.

## Significant findings from the audit of the financial statements

**27.** 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 SNH's accounting practices. The significant findings are summarised in [Exhibit 3](#).

### Exhibit 3

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

Issue	Resolution
<p><b>1. Impact of Covid-19 on the valuation of land and buildings</b></p> <p>SNH's land and buildings portfolio (£21.7 million) is valued in full every five years with interim valuations of 25% of the portfolio undertaken in each of the intervening years. The valuations are provided by an external valuer, the Valuation Office Agency.</p> <p>Twelve properties were valued in 2019/20 at a total value of £16.8 million. The Valuation Office Agency's report contains a 'material valuation uncertainty' clause regarding the impact of Covid-19. It points out that a higher degree of caution should be attached to the valuations than would normally be the case.</p> <p>The unaudited accounts did not make reference to this material uncertainty.</p>	<p>We discussed this with SNH finance staff who agreed to include an appropriate disclosure in Note 15 (Property, plant and equipment) and a cross-reference in the accounting policy on critical accounting estimates and judgements.</p> <p>We added an Emphasis of Matter paragraph to the independent auditor's report because we believe the disclosure is fundamental to users' understanding of the accounts.</p> <p>The audit opinion is not modified in respect of this matter.</p> <p>We have sought and received the Accountable Officer's assurances on management's assessment of the fair value of land and property in the ISA 580 representation letter.</p>
<p><b>2. Overstatement of prepayments</b></p> <p>Net expenditure and trade and other payables were understated by £55,000 and £10,000 respectively and trade and other receivables were overstated by £65,000 due to errors in the calculation of a year-end prepayment and the omission of an accrual. As a result, net assets were overstated by £55,000.</p>	<p>The audited financial statements have been amended to correct this misstatement.</p>
<p><b>3. Misclassification of income transactions</b></p> <p>Staff costs and income from activities were overstated by £158,000 in the Statement of Comprehensive Net Expenditure due to miscoding of income received from the secondment of staff.</p>	<p>The audited financial statements have been amended to correct this misclassification. There is no impact on reserves.</p>

## The financial statements were adjusted to reflect all of our audit findings decreasing net assets by £57,000

28. Presentational and monetary adjustments to the accounts identified during the audit process were discussed with management who agreed to amend the financial statements. These adjustments included correction of a small number of coding errors which were identified by the finance team, after submission of the accounts for audit, as part of their quality control procedures. There are no unadjusted misstatements in excess of our reporting thresholds to report to those charged with governance.

29. The net effect of the adjustments identified during the audit process (including those identified by the finance team) was to increase net expenditure and decrease net assets by £57,000.

## Finance team capacity

30. Last year we recommended that SNH should review the capacity of its finance team to ensure that it was sufficient to meet its needs. In response, a review was undertaken which concluded that there was sufficient capacity as staff had returned to their substantive roles following implementation of the new finance and human resources system. Our 2019/20 audit work supported that conclusion.

31. The Head of Finance, Planning and Performance resigned in March 2020 and left the organisation at the start of June 2020. Since then, the duties of this key post have been shared between a number of senior finance staff. This resulted in additional pressure on key staff as they supported the audit process and faced the challenges of remote working. This post remains vacant at the time of drafting this report.



### Recommendation 1

**SNH should progress recruitment to this key post in order to ensure there is sufficient senior finance staff capacity to support the organisation as it plans for its longer-term recovery from the impact of Covid-19.**

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## Some progress was made on prior year recommendations

32. SNH has made some progress in implementing our prior year audit recommendations. For the action not yet implemented, a revised response and timescale has been agreed with management and are set out in [Appendix 1](#).

# Part 2

## Financial management



### Main judgements

SNH has effective financial management arrangements which enabled it to operate within its resource allocation in 2019/20.

Key controls in core financial systems operated effectively during 2019/20.

Appropriate arrangements are in place for the prevention and detection of fraud and corruption.

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

### SNH operated within budget in 2019/20

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

34. SNH's performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#). SNH reported an outturn of £57.106 million underspending its overall DEL budget for 2019/20 by £1.026 million.

### Exhibit 4 Performance against DEL in 2019/20

	Initial budget £'000	Final budget £'000	Outturn £'000	Underspend £'000
Resource DEL	45.500	56.882	55.882	(1.000)
Capital DEL	1.000	1.250	1.224	(0.026)
<b>Total DEL</b>	<b>46.500</b>	<b>58.132</b>	<b>57.106</b>	<b>(1.026)</b>

Source: Scottish Natural Heritage Annual Report and Accounts 2019/20

## Two ring-fenced projects account for the majority of the underspend

**35.** During the year, amendments were made to the 2019/20 budget due to increases in funding provided by the Scottish Government. These included an additional £10 million to fund peatland restoration, £1 million for Biodiversity Challenge Fund projects and £1 million to fund increased pension contributions offset by the surrender of £1.2 million to support Scotland's Rural Development Programme.

**36.** In addition, SNH agreed with the Scottish Government that it would underspend its capital budget by £0.006 million. The £1.026 million underspend above includes the 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 budget by £1.020 million.

**37.** The majority of this underspend relates to two ring-fenced projects: the Biodiversity Challenge Fund (£0.430 million) and peatlands restoration (£0.203 million). As in previous years, the peatland restoration project was impacted by poor weather, lack of contractor availability and lower than expected uptake by landowners. Biodiversity Challenge Fund projects were impacted by delays in securing permissions from landowners. Both projects were impacted by Covid-19 with work on all sites halted on 23 March 2020.

**38.** As part of our audit we reviewed SNH's budget setting and monitoring arrangements, including monitoring reports presented to the Board and concluded that SNH has appropriate budget setting and monitoring arrangements in place. Our review included consideration of internal audit's report on budget management which concluded that controls in place are adequate and effective.

## Financial systems of internal control are operating effectively

**39.** As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to the production of the financial statements. Our objective is to gain assurance that SNH has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**40.** The findings from our review of systems of internal control were included in the Management Report presented to the Audit and Risk Committee on 13 May 2020. We concluded that the key controls tested were operating effectively with the exception of the timely completion of reconciliations and independent review of journal entries. As part of our financial statements audit, we confirmed that reconciliations were up to date and completed timeously, and that the retrospective check of journal entries had been completed.

**41.** In response to Covid-19, SNH revised its controls over the authorisation of payments in recognition that site visits could no longer take place. As part of the final accounts audit, we reviewed this procedure and a sample of the resulting expenditure transactions and did not identify any issues.

**42.** We are content that SNH's control environment provides a sound basis for the preparation of the financial statements.

## Internal audit is effective

**43.** 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 the work of internal audit.

**44.** Internal audit is provided by SNH's in-house internal audit team supported by specialist and additional resources provided through a co-sourcing contract with BDO (during 2019/20) and Scott-Moncrieff with effect from 2020/21.

**45.** Our review concluded that SNH's internal audit arrangements are effective. While we chose not to place formal reliance on the work of internal audit, we did consider three of its reviews - corporate governance arrangements, staff awareness of conflicts of interest procedures and budget management – to support our wider dimension audit responsibilities.

### **Standards of conduct and arrangements for the prevention and detection of fraud and error are appropriate**

**46.** SNH is responsible for establishing arrangements for the prevention and detection of fraud, error, irregularities, bribery and corruption and for ensuring that its affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

**47.** We reviewed the arrangements to maintain standards of conduct through the codes of conduct in place for both staff and Board members. We also reviewed the fraud policy and response plan, and whistleblowing policy.

**48.** SNH also participates in the National Fraud Initiative, a counter-fraud exercise which aims to prevent and detect fraud across the public sector. As reported in our Management Report, we are satisfied that SNH was pro-active in reviewing NFI matches and conducting the appropriate investigations, although implementation of the new FUSION application meant progress was slower than in the previous year. No frauds or errors were identified as a result of this exercise. This provides additional assurance over SNH's fraud prevention and detection arrangements.

**49.** We concluded that there are appropriate arrangements for the prevention and detection of fraud, error and corruption. We are not aware of any specific issues that we need to bring to your attention.

### **Arrangements for preventing fraud and corruption in the procurement function are appropriate**

**50.** Our consideration of financial management included an evaluation of SNH's arrangements for preventing and detecting fraud and corruption in its procurement function.

**51.** We reported the findings in our Management Report and concluded that appropriate arrangements are in place to mitigate the risk of fraud in procurement activities but more needed to be done to ensure that staff responsible for leading procurement activity totalling less than £50,000 are appropriately trained.

# Part 3

## Financial sustainability



### Main judgements

**SNH is updating its 2020/21 business plan to reflect the impact of Covid-19. It is anticipated that SNH will be asked to support the Scottish Government with its long-term recovery plans although the implications of this on future funding is not yet known.**

**SNH has yet to develop a medium or longer-term financial plan.**

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

### The 2020/21 budget and business plan are being reviewed to reflect the ongoing impact of Covid-19

**52.** The 2020/21 budget setting process began in September 2019 with the Board's consideration of its strategic priorities for the coming year. The Board approved the 2020/21 budget, in March 2020, as part of the 2020/21 Business Plan. This shows that SNH plans to invest £50.1 million in nature during 2020/21 and that this will be funded by £47.1 million grant in aid from the Scottish Government (2019/20 £46.5 million) and additional funding for specific projects. Due to Covid-19, the Business Plan has not been published on SNH's website.

**53.** The budget incorporates a number of budgetary pressures including an increase in the amount allocated for paybill costs resulting in a reduction of 11% in the funding available for projects to support delivery of SNH's strategic priorities.

**54.** Lockdown has had a major impact on SNH's ability to progress some of its core activities in 2020/21. SNH is currently reviewing its 2020/21 budget and business plan to ensure its business-critical activities align with Scottish Government guidance on service delivery and staff welfare.

**55.** The Covid-19 pandemic will have a huge impact on Scottish Government finances in 2020/21 and it is likely that funding will require to be reprioritised across public sector bodies. It is anticipated that SNH will be asked to support the Scottish Government with its long-term recovery plans although the implications of this on future funding is not yet known.

### SNH has yet to develop a longer-term financial plan

**56.** In previous years we have recommended that SNH should develop medium (two to five years) to longer-term (five to ten years) financial plans in order to identify and address risks to its financial sustainability and long-term vision for Scotland's nature and landscape. Limited progress was made with this in 2019/20 with the 2020/21 budget continuing to cover only a one-year period.

57. SNH recognises that further work is required in this area. We have been advised that SNH's operating model is currently being reviewed. This work will include review of the budget setting process and the assumptions used which will form the basis for medium to longer-term financial planning. Covid-19 is likely to have a significant impact on Scottish Government finances for the foreseeable future. Medium and longer-term financial planning will enable SNH to better understand the impact of proposed changes and its capacity to take on new challenges and initiatives.



#### **Recommendation 4 (prior year)**

**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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# Part 4

## Governance and transparency



### Main judgements

**SNH had appropriate governance arrangements in place during 2019/20. It has made changes to its operating environment and governance arrangements in response to the impact of Covid-19.**

**The performance report included in the audited annual report and accounts meets the requirements of the FReM with scope for further improvement.**

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

### Appropriate governance arrangements were in place during 2019/20

**58.** SNH is governed by a Board that is accountable to the Scottish Ministers. At 31 March 2020, the Board consisted of the chair, eight non-executive members and the chief executive. There were seven Board meetings during 2019/20. The Board is also supported by three committees: Audit and Risk, Protected Areas and Scientific Advisory.

**59.** In assessing governance and transparency arrangements we consider:

- Board and committee structure and conduct
- overall arrangements and standards of conduct including those for the prevention and detection of fraud, error, bribery and corruption. This includes action in response to the National Fraud Initiative
- openness of Board and committees
- public access to information via websites
- reporting of performance and whether this is fair, balanced and understandable.

**60.** We concluded the SNH had appropriate governance arrangements in place during 2019/20.

### Covid-19 has affected SNH's governance arrangements

**61.** SNH has amended its governance arrangements as a result of the Covid-19 pandemic. SNH's Business Continuity Group led the initial response to the pandemic, implementing the existing incident management and response plan. As a result, SNH has been able to continue to operate during the lockdown period.

**62.** At the start of the lockdown, all SNH employees already had the necessary equipment to allow them to work remotely. As lockdown continued staff were permitted to purchase additional equipment, such as full-size monitors, to improve their home working environment. Other changes made in response to the pandemic include:

- Board and committee meetings have been held virtually with no changes required to the original dates
- monitoring activity, site visits and volunteering activity have been suspended in line with Scottish Government guidance
- supporting grant recipients by keeping funding flowing and being as flexible as possible about unavoidable changes to activities, timelines and reporting.

**63.** We have concluded that SNH has been proactive in dealing with the changed operating environment. We will assess the new arrangements as part of our 2020/21 audit. The scale and pace of change as a result of Covid-19 poses a risk that key financial controls will not operate as intended. Arrangements need to be put in place to ensure that these remain effective.



## **Recommendation 2**

**SNH should ensure that internal controls remain effective during the period of uncertainty and new ways of working.**

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### **Arrangements for openness and transparency have improved**

**64.** There continues to be a focus on how public organisations demonstrate the best use of public money. Openness and transparency in how a body operates and makes decisions is key to supporting understanding and scrutiny. Transparency means that the public have 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 there was scope for SNH to improve its openness and transparency. In response, Internal Audit reviewed SNH's approach to the openness and transparency of Board decision-making and the publication of information on its website.

**66.** The Internal Audit report identified areas of good practice and concluded that SNH compared favourably to other central government bodies reviewed. The report made some suggestions to improve the existing arrangements including making open session papers proactively available on the website. We are pleased to report that all Board and committee minutes and open session papers are now easily accessible on the SNH website.

### **The performance report could be further improved**

**67.** In addition to the opinion on the performance report covered in [Part 1](#) of this report, we also consider the qualitative aspects of the performance report. The purpose of a performance report is to provide information on a body, its main objectives and the principal risks it faces. It should provide a fair, balanced and understandable analysis of a body's performance as well as helping stakeholders understand the financial statements.

**68.** In May 2020, HM Treasury issued an addendum to the 2019/20 Government Financial Reporting Manual (FReM) giving guidance on minimum reporting requirements. This permitted bodies to omit the more detailed performance analysis section from their 2019/20 performance reports. Due to the timing of the addendum, SNH chose not to adopt the reduced reporting requirements.

**69.** From our review of the annual report submitted for audit, we concluded that there was scope to provide a more balanced picture of performance in 2019/20. We discussed this with management who agreed to update the narrative. We consider the revised narrative provides a more complete picture of SNH's performance and we concluded that the audited performance report met the requirements of the FReM.

**70.** Annex 5 of the FReM gives additional guidance for narrative reporting. It refers to the use of trend analysis, balanced reporting, plain English, use of infographics and advises the preparer to go beyond the minimum requirements. In our view, SNH's performance report could be further enhanced by linking better the individual sections. Further guidance can be found in Audit Scotland's 2019 report: [Good Practice Note on Performance Reports in Central Government](#).



### **Recommendation 3**

**SNH should review the content and presentation of its performance report against Annex 5 of the FReM and Audit Scotland's good practice guide.**

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# Part 5

## Value for money



### Main judgements

**SNH has an appropriate best value framework in place.**

**A well-developed performance management system is in place. 75% of key deliverables were achieved or on track by the year-end.**

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

### SNH has an appropriate best value framework

**71.** *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. The guidance sets out the key principles of best value and the requirement to have a systematic approach to self-evaluation and continuous improvement.

**72.** The Chief Executive of SNH is the designated Accountable Officer. A range of processes are in place to help the Accountable Officer demonstrate best value. These include:

- the development of a four-year corporate plan together with an annual business plan
- regular monitoring of performance including financial performance against budget
- appropriate governance and accountability arrangements including a systematic approach to risk management
- an established approach to partnership working, which underpins much of what SNH does
- building sustainability into how it operates through procurement practice, the greening of its offices, sharing accommodation with other organisations, its approach to travel and how it uses energy.

### A well-developed performance management system is in place. 75% of key deliverables were achieved or on track at the year-end

**73.** 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.

**74.** The corporate plan is supported by the 2019/20 business plan 'It's in our Nature: Year Two' which sets out the highlights the Board plans to deliver in 2019/20 against each of the four outcomes in the corporate plan. These highlights are supported by 15 activities and 64 key deliverables and performance against these 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.

**75.** Performance reports use a traffic light system to report progress against each of the activities and key deliverables. The annual report and accounts highlights that, as at 31 March 2020, 48 (75%) key deliverables were achieved or on-track; 14 (22%) were showing minor slippage which was expected to be recovered in early 2020/21 and 3 (5%) (delivery of favourable condition on protected nature sites; completion of Natura Conservation Advice Packages for terrestrial Special Area of Conservations; and being an active, valued and inclusive partner in development planning) were experiencing significant slippage. Plans are in place to recover this slippage during 2020/21.

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

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

## Covid-19 has had an impact on performance

**78.** Covid-19 has had a major impact on SNH's ability to deliver on its planned priorities and other essential work in quarter 1 of 2020/21. In response, SNH developed an emergency business plan for quarter 1 to give staff clarity on its immediate priorities and how it planned to focus available resources.

**79.** Many staff have been able to continue with their normal work but for others, working on National Nature Reserves and other outdoor projects, this has not been possible. These staff have been given the opportunity to contribute to other areas of SNH's work. Tasks that cannot be delivered during lockdown have been postponed and all site-based activity, including peatlands restoration and Biodiversity Challenge Fund projects, has been reviewed to identify any business critical work which had to continue e.g. in relation to animal welfare, and to prioritise remaining work ready for the easing of restrictions in later phases of the Scottish Government's 'Route Map through and out of the crisis'.

**80.** A Strategic Business Recovery Group has been set up to provide structure and direction on immediate priorities and to plan for longer term recovery. SNH aims to emerge from the pandemic stronger and more resilient than before.

## National performance audit reports

**81.** 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 2019/20 which were of direct interest to SNH, there were others with some wider relevance. These are outlined in [Appendix 3](#).

**82.** Summaries of relevant Audit Scotland reports are prepared by the Head of Internal Audit or Head of Finance, Planning and Performance for the Accountable Officer. These summaries are circulated to appropriate officers and presented quarterly to the Audit and Risk Committee.

# Appendix 1

## Action plan 2019/20



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Key finance post remains vacant</b></p> <p>The Head of Finance, Planning and Performance post has been vacant since the beginning of June.</p> <p><b>Risk:</b> there is a risk that SNH does not have sufficient financial capacity to support the organisation as it plans for its longer-term recovery from the Covid-19 pandemic.</p>	<p>SNH should progress recruitment to this key post in order to ensure there is sufficient senior finance staff capacity to support the organisation as it plans for its longer-term recovery from the impact of Covid-19.</p> <p><a href="#">Recommendation 1, paragraph 31.</a></p>	<p>All recruitment was paused during the Covid-19 lockdown. Recruitment has been approved and steps have now been taken to commence recruitment for the Head of Finance, Planning &amp; Performance post.</p> <p><b>Responsible officer:</b> Director Business Services &amp; Transformation</p> <p><b>Agreed date:</b> July 2020</p>
2	<p><b>Internal control arrangements</b></p> <p>The scale and pace of change as a result of Covid-19 poses a risk to SNH's governance arrangements.</p> <p><b>Risk:</b> there is a risk that key financial controls do not operate as intended due to new ways of working.</p>	<p>SNH should ensure that internal controls remain effective during this period of uncertainty and new ways of working.</p> <p><a href="#">Recommendation 2, paragraphs 61 to 63.</a></p>	<p>A review of risks to organisational resilience has been completed by the Head of Internal Audit, in response to Covid-19. This has included a Fraud Risk Assessment, and action to review budget and financial management controls. We are keeping our internal controls under regular review.</p> <p><b>Responsible officer:</b> Head of Internal Audit</p> <p><b>Agreed date:</b> June 2020 then review every 6 to 8 weeks</p>
3	<p><b>Annual report narrative</b></p> <p>The annual report narrative could be improved to ensure it is balanced and transparent.</p> <p><b>Risk:</b> there is a risk that SNH fails to communicate effectively with its stakeholders.</p>	<p>SNH should review the content and presentation of its performance report against Annex 5 of the FReM and Audit Scotland's good practice guide.</p> <p><a href="#">Recommendation 3, paragraphs 67 to 70.</a></p>	<p>Where possible in the time available we have sought to improve the balance in the 2019/20 Performance Report. We will further consider the Good Practice Note on Performance Reports as part of our preparation of the 2020/21 Annual Report and Accounts.</p> <p><b>Responsible officer:</b> Deputy Director Business Services &amp; Transformation</p> <p><b>Agreed date:</b> May 2021</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
<b>Follow up of prior year recommendations</b>			
4	<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><a href="#">Recommendation 4, paragraphs 56 and 57.</a></p>	<p><b>Outstanding</b></p> <p>Refer to Part 3, paragraphs 52 to 57.</p> <p>As part of developing our new operating model we are revising our approach to corporate and business planning. This work will include action to develop medium- and longer-term financial plans.</p> <p><b>Responsible officer:</b></p> <p>Head of Finance, Planning &amp; Performance</p> <p><b>Revised date:</b> December 2020</p>
5	<p><b>Finance team capacity</b></p> <p>During the 2018/19 audit 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><b>Complete</b></p> <p>Refer to Part 1, paragraph 30.</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>Auditing Standards require that audits are planned to consider the risk of material misstatement caused by fraud which is presumed to be a significant risk in any audit. This includes the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries and other period end adjustments.</p> <p>Review of accounting estimates for bias.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p><b>Results:</b></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>Conclusion:</b> Satisfactory</p>
<p><b>2 Risk of fraud over expenditure</b></p> <p>As most public sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure. Scottish Natural Heritage makes significant grant payments to third parties. Due to the nature of these expenditure streams there is an inherent risk of fraud over expenditure.</p>	<p>Walkthrough of controls over payables.</p> <p>Focused testing of authorisation of grant payments.</p> <p>Substantive testing of expenditure payments relating to grants.</p> <p>Review of action taken to investigate and clear data matches resulting from the NFI exercise.</p>	<p><b>Results:</b></p> <p>Our walkthrough of controls over payables did not identify any issues.</p> <p>Our testing of authorisation of grant payments identified one grant payment where evidence had not been retained to support the payment made. We extended our sample and confirmed that this was an isolated incident (refer to paragraph 15 of our Management Report).</p> <p>Our substantive testing of grant payments did not identify any issues.</p> <p>SNH has investigated all recommended NFI matches. No frauds or errors were found.</p> <p><b>Conclusion:</b> Satisfactory</p>



Audit risk	Assurance procedure	Results and conclusions
<p><b>3 Estimation 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>Assessment of the scope, independence and competence of the professionals engaged to provide valuations.</p> <p>Substantive testing of transactions in 2019/20.</p>	<p><b>Results:</b></p> <p>Our audit work did not identify any issues with the scope, independence or competence of the expert valuers (Valuation Office Agency).</p> <p>We considered the work undertaken by management and its expert valuer in light of the Covid-19 pandemic and considered the impact on the year-end valuations.</p> <p>Refer to Exhibit 1, point 1.</p> <p>In response to the Covid-19 pandemic we focused our substantive testing of accruals on areas which were most likely to be impacted (e.g. peatland restoration claims). No issues were identified.</p> <p><b>Conclusion:</b> Satisfactory</p>
<p><b>4 New finance and HR system</b></p> <p>A new cloud-based finance and HR system was phased in during 2019/20. There is a risk that the financial statements are materially misstated due to:</p> <ul style="list-style-type: none"> <li>the system not operating as expected</li> <li>opening balances being incorrectly input to the new system.</li> </ul> <p>There is also a risk that the customised reports used in the preparation and audit of the financial statements will not be available from the new system which may impact on the ability to deliver the accounts and audit within the agreed timescales.</p>	<p>Initial systems review of all core financial systems, including payroll.</p> <p>Walkthrough of key controls.</p> <p>Focussed testing of key controls.</p> <p>Verification of opening balances input to the new system.</p> <p>Liaise with key financial staff and request key reports required for audit purposes.</p>	<p><b>Results:</b></p> <p>Our initial system reviews and controls work did not identify any issues with the systems or the controls in operation except for delays in the completion of reconciliations during the period of system implementation. These delays were resolved by October 2019 and there was no impact on the year-end position.</p> <p>Our checks on opening balances did not identify any issues.</p> <p>No problems were encountered with accessing reports from the new system for audit purposes.</p> <p><b>Conclusion:</b> Satisfactory</p>

Audit risk	Assurance procedure	Results and conclusions
<b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b>		
<p><b>5 Financial sustainability</b></p> <p>Tough choices were required to balance the 2019/20 budget as cost pressures resulted in a 17% reduction in the amount available to fund projects designed to support Scottish Natural Heritage's strategic priorities. Current projections are that the paybill and fixed costs will continue to increase putting further pressure on project budgets.</p> <p>Management acknowledge the need to develop medium-and longer-term financial planning to ensure future financial sustainability. Without this, there is a risk that the Scottish Natural Heritage will not be able to deliver the strategic outcomes set out in the 2018-2022 Corporate Plan.</p>	<p>Review of 2019/20 outturn against budget.</p> <p>Review of 2020/21 budget setting process.</p> <p>Review of medium-and long-term financial plans including scenario planning.</p>	<p><b>Results:</b></p> <p>SNH operated within its resource allocation in 2019/20 (refer to paragraph 34).</p> <p>The 2020/21 budget contains a number of budgetary pressures. Covid-19 will have a huge impact on Scottish Government finances in 2020/21. It is anticipated that SNH will be asked to support the Scottish Government's long-term recovery plans although the implications of this on future funding is not yet known (refer to paragraphs 52 to 55).</p> <p>Limited progress has been made with the development of medium and longer-term financial planning. SNH has recognised that further work is required in this area (refer to paragraphs 56 and 57).</p> <p><b>Conclusion:</b> Limited progress has been made with medium and longer-term financial planning in 2019/20.</p>
<p><b>6 Introduction of IFRS 16 Leases</b></p> <p>The Government Financial Reporting Manual (FReM) requires IFRS 16 Leases, as adapted and interpreted by the FReM, to be applied to public sector bodies with effect from 1 April 2020. Early work is required to assess the practical implications and ensure arrangements are in place to support adoption of this IFRS.</p>	<p>Ongoing engagement to assess preparation for the implementation of IFRS16 Leases.</p>	<p><b>Results:</b></p> <p>The Financial Reporting Advisory Board (FRAB) agreed, in March 2020, to delay the implementation of IFRS16 to 1 April 2021 due to Covid-19.</p> <p>As reported in our Management Report, our interim audit work noted that SNH had undertaken extensive preparatory work in identifying and quantifying its leases, discussing the appropriate accounting treatment with the Scottish Government and other public sector bodies, and procuring a lease accounting module to assist with the implementation and ongoing management of leases under IFRS 16.</p> <p>The estimated impact of this new accounting standard has been quantified and disclosed within the annual report and accounts.</p> <p><b>Conclusion:</b> Satisfactory</p>

# Appendix 3

## Summary of national performance reports 2019/20

		 <b>2019/20 Reports</b>	
		Apr	
Social security: Implementing the devolved powers		<b>May</b>	
Scotland's colleges 2019		<b>Jun</b>	 Enabling digital government
		Jul	
NHS workforce planning - part 2		<b>Aug</b>	
Finances of Scottish universities		<b>Sept</b>	
NHS in Scotland 2019		<b>Oct</b>	
		Nov	
Local government in Scotland: Financial overview 2018/19		<b>Dec</b>	
Scotland's City Region and Growth Deals		<b>Jan</b>	 Privately financed infrastructure investment: The Non-Profit Distributing (NPD) and hub models
		Feb	
		<b>Mar</b>	 Early learning and childcare: follow-up

### Central Government relevant reports

[Social security: Implementing the devolved powers](#) – May 2019

[Enabling digital government](#) – June 2019

[Scotland's City Region and Growth Deals](#) – October 2019

[Privately financed infrastructure investment: The Non-Profit Distributing \(NPD\) and hub models](#) – Jan 2020

[Early learning and childcare: follow-up](#) – March 2020

# Scottish Natural Heritage

## 2019/20 Annual Audit Report

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