

Scottish Natural Heritage

2017/18 Annual Audit Report



 AUDIT SCOTLAND

Prepared for Scottish Natural Heritage and the Auditor General for Scotland

26 July 2018

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.

Contents

Key messages	4
Introduction	5
Part 1 Audit of 2017/18 annual report and accounts	7
Part 2 Financial management	10
Part 3 Financial sustainability	13
Part 4 Governance and transparency	16
Part 5 Value for money	20
Appendix 1 Action plan 2017/18	21
Appendix 2 Significant audit risks identified during planning	22
Appendix 3 Summary of national performance reports 2017/18	25

Key messages

2017/18 annual report and accounts

- 1 The financial statements of Scottish Natural Heritage for 2017/18 give a true and fair view of the state of its affairs and of its net expenditure for the year.
- 2 Expenditure and income were incurred or applied in accordance with applicable enactments and guidance issued by Scottish Ministers.
- 3 The performance report, governance statement and the audited part of the remuneration and staff report were consistent with the financial statements and properly prepared in accordance with the accounts direction.

Financial management

- 4 Scottish Natural Heritage effectively managed its finances in 2017/18.
- 5 Systems of internal control operated effectively in 2017/18.
- 6 Arrangements for identifying and recording potential conflicts of interest have been assessed as good practice as they cover all Board members, directors and staff.

Financial sustainability

- 7 Scottish Natural Heritage's financial planning arrangements are continuing to develop and medium term financial planning has been used to consider the effects of decreasing resources on the future delivery of its corporate priorities. The recent publication of the Scottish Government's five-year financial strategy provides scope to further develop medium and longer term financial planning.

Governance and transparency

- 8 Scottish Natural Heritage has appropriate arrangements in place to support good governance, accountability and scrutiny.
- 9 Internal audit is effective and operates in accordance with the Public Sector Internal Audit Standards.
- 10 Scottish Natural Heritage reviewed its approach to accessibility, openness and transparency during the year. Plans are in place to enhance public engagement and raise awareness of the new Corporate Plan 2018-2022: Connecting People and Nature. The number of Board meetings has increased and these will continue to be held in public. Agendas and Board minutes will be published on the website but access to Board papers will be by request and at the discretion of the Chair. Audit and Risk Committee meetings continue to be held in private.

Value for money

- 11 Scottish Natural Heritage has an effective performance management framework in place which supports the achievement of value for money.

Introduction

1. This report summarises the findings from our 2017/18 audit of Scottish Natural Heritage.
2. The scope of our audit was set out in our Annual Audit Plan presented to the February 2018 meeting of the Audit and Risk Committee. This report comprises the findings from:
 - an audit of Scottish Natural Heritage’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](#).

Exhibit 1

Audit dimensions



Source: *Code of Audit Practice 2016*

3. The main elements of our audit work in 2017/18 have been:
 - a review of Scottish Natural Heritage’s main financial systems
 - an audit of Scottish Natural Heritage’s 2017/18 annual report and accounts including the issue of an independent auditor’s report setting out our opinions
 - consideration of the four audit dimensions.

4. Scottish Natural Heritage 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. Scottish Natural Heritage's annual report and accounts includes the following:

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

5. Scottish Natural Heritage is also responsible for establishing effective arrangements for governance, propriety and regularity that enable the Board to successfully deliver its objectives.

6. Our responsibilities as independent auditor are outlined in 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.

7. As public sector auditors we give independent opinions on the annual report and accounts. We also review and provide conclusions on the effectiveness of the performance management arrangements, suitability and effectiveness of corporate governance arrangements, and financial position and arrangements for securing financial sustainability. 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.

8. 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.

9. 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 outstanding actions from last year and the steps being taken to implement them.

10. 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 and, therefore, the 2017/18 audit fee of £55,850 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

Adding value through the audit

11. Our aim is to add value to Scottish Natural Heritage by increasing insight into, and offering foresight on, financial sustainability, risk and performance, by identifying areas for improvement and by recommending and encouraging good practice. In so doing, we aim to help the Board promote improved standards of governance, better management and decision making and more effective use of resources.

12. This report is addressed to both the Board and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

13. We would like to thank all management and staff who have been involved in our work for their cooperation and assistance during the audit.

Part 1

Audit of 2017/18 annual report and accounts



Main judgements

The financial statements of Scottish Natural Heritage for 2017/18 give a true and fair view of the state of its affairs and of its net expenditure for the year.

Expenditure and income were incurred 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 accounts direction.

Audit opinions on the annual report and accounts

14. The annual report and accounts for the year ended 31 March 2018 were approved by the Audit and Risk Committee on 26 July 2018. We reported within our independent auditor's report that in our opinion:

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

15. Additionally, we have nothing to report in respect of misstatements in the 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

16. We received the unaudited financial statements on 31 May 2018 in line with our agreed audit timetable.

17. The working papers provided with the unaudited financial statements were of a good standard and finance staff provided support to the audit team which helped ensure the final accounts audit process ran smoothly.

Whole of Government Accounts (WGA)

18. In accordance with the WGA guidance we will complete the required assurance statement and submit it to the National Audit Office (NAO) by the 30 September 2018 deadline.

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

Risk of material misstatement

19. [Appendix 2](#) provides a description of those assessed risks of material misstatement that were identified during the planning process. These risks had the greatest effect on the overall audit strategy, the allocation of staff resources to the audit and directing the efforts of the audit team. Also included within the appendix are wider audit dimension risks, how we addressed these and conclusions.

Materiality

20. 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. It involves considering both the amount and nature of the misstatement.

21. Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit. Specifically, regarding the annual report and accounts we assess the materiality of uncorrected misstatements, both individually and collectively.

22. On receipt of the annual report and accounts we reviewed our materiality calculations and revised them accordingly. These are summarised in [Exhibit 2](#).

Exhibit 2

Materiality values

Materiality level	Amount
Overall materiality	£492,000
Performance materiality	£369,000
Reporting threshold	£20,000

Source: Annual Audit Plan 2017/18

How we evaluate misstatements

23. Presentational and monetary adjustments to the unaudited accounts were discussed with senior finance officers who agreed to amend the financial statements. There are no unadjusted misstatements.

24. The net effect of the adjustments processed was to increase net expenditure and decrease net assets by £96,000. This related to late confirmation from HMRC of a liability resulting from a recent VAT inspection.

Significant findings from the audit in accordance with ISA 260

25. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance. These are summarised in [Exhibit 3](#).

26. These findings include our views about significant qualitative aspects of Scottish Natural Heritage's accounting practices including:

- accounting policies
- significant financial statements disclosures
- the impact on the financial statements of any uncertainties
- misstatements in the annual report and accounts
- accounting estimates and judgements
- timing of transactions and the period in which they are recorded
- the effect of any unusual transactions on the financial statements
- disagreement over any accounting treatment or financial statements disclosure.

Exhibit 3

Significant findings from the audit of the financial statements

Issue	Resolution
<p>1. Property, plant & equipment</p> <p>Last year finance staff completed an exercise to ensure the balance on the revaluation reserve equalled the total of the revaluation balances on the individual assets held by Scottish Natural Heritage. Our testing this year noted that revaluation balances resulting from the indexation of motor vehicles and other equipment had been omitted in error from the revised revaluation balance last year. As a result, the general reserve was overstated and the revaluation reserve was understated by £93,000 as at 31 March 2018.</p>	<p>The audited financial statements have been amended to reflect this misstatement. The general reserve has been decreased and the revaluation reserve increased by £93,000.</p>
<p>2. HMRC accrual</p> <p>Following receipt of the unaudited accounts, finance staff advised that they had identified an additional accrual for inclusion in the 2017/18 accounts relating to an emerging VAT and employment tax liability resulting from an HMRC investigation. We reviewed the calculations provided in support of the proposed £96,000 adjustment, the proposed accounting treatment and the subsequent assessment received from HMRC and concluded that it was appropriate to include the liability as an accrual in the audited accounts.</p>	<p>The audited financial statements have been amended to reflect this late adjustment. Net expenditure and trade payables have been increased and the general reserve has been decreased by £96,000.</p>

Source: Audit Scotland

Part 2

Financial management



Main judgements

Scottish Natural Heritage effectively managed its finances in 2017/18.

Systems of internal control operated effectively in 2017/18.

Arrangements for identifying and recording potential conflicts of interest have been assessed as good practice as they cover all Board members, directors and staff.

Financial performance in 2017/18

27. The main financial objective for Scottish Natural Heritage is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

28. Scottish Natural Heritage's performance against Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME) is shown in [Exhibit 4](#). Scottish Natural Heritage reported an outturn of £47.869 million for 2017/18, underspending its overall budget by £3.855 million and so met this objective in 2017/18.

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

Exhibit 4

Performance against DEL and AME in 2017/18

Performance	Initial budget £000	Final budget £000	Actual outturn £000	Overspend/ (underspend) £000
Resource DEL	43,127	50,224	46,830	(3,394)
Capital DEL	1,500	1,500	1,039	(461)
Total DEL	44,627	51,724	47,869	(3,855)
Annually managed expenditure (AME)	-	58	143	85
Total Allocation	44,627	51,782	48,013	(3,770)

Source: Scottish Government Autumn and Spring Budget Revision letter to Scottish Natural Heritage and Scottish Natural Heritage Annual Report and Accounts 2017/18

Budget underspend agreed with the Scottish Government

29. During 2017/18, Scottish Natural Heritage agreed with the Scottish Government that it would underspend its budget by £1.3 million. The £3.9 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, Scottish Natural Heritage underspent its DEL by £2.6 million. The majority of this underspend relates to delays in progressing the peatland restoration project due to bad weather in late 2017/early 2018.

Budgetary processes

30. Many adjustments were made to Scottish Natural Heritage's original budget. These included an additional £6.1 million to fund peatland restoration, £0.4 million for various other initiatives, and the surrender of £1.2 million to support Scotland's Rural Development Programme.

31. We reviewed Scottish Natural Heritage's budgetary processes and budget monitoring arrangements, including monitoring reports presented to the Board, and concluded that appropriate budget setting and monitoring arrangements are in place.

Systems of internal control

32. 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 gain assurance that Scottish Natural Heritage has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

33. We reported the findings from our interim testing, and our conclusion that the controls tested were operating effectively, in our management report presented to the Audit and Risk Committee in May 2018. We did not identify any significant internal control weaknesses which could affect Scottish Natural Heritage's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

34. Within our management report we noted there was a risk that vacancy issues within the finance team might adversely impact on the timeliness of year end reconciliations. Finance staff prioritised the preparation of the annual accounts and the associated working papers, including reconciliations, and no issues were noted in this area during the audit of the financial statements.

Prevention and detection of fraud and irregularity

35. We assessed Scottish Natural Heritage's arrangements for the prevention and detection of fraud. Our audit work covered many areas such as whistleblowing and review of the fraud policy and response plan document.

36. We concluded that Scottish Natural Heritage is proactive in promoting fraud awareness and had appropriate and adequate arrangements in place for fraud detection and prevention during 2017/18. There were no instances of fraudulent activity investigated during the year.

National Fraud Initiative

37. 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.

38. In our Annual Audit Report in 2016/17 we summarised the NFI activity and can confirm that all recommended matches have been investigated. A full report of the findings, including the completed self-assessment questionnaire was presented to the Audit and Risk Committee in August 2017. No frauds were found and we are satisfied that Scottish Natural Heritage was pro-active in investigating matches and conducting the appropriate investigations.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

39. We reviewed the arrangements in place to maintain standards of conduct including the staff Code of Conduct and Board Members' Code of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

40. Scottish Natural Heritage 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 within one month. In addition, all staff are required to review and update their register of interests annually or as soon as changes have occurred. This enables early identification of any circumstances 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.

Part 3

Financial sustainability



Main judgements

Scottish Natural Heritage's financial planning arrangements are continuing to develop and medium term financial planning has been used to consider the effects of decreasing resources on the future delivery of its corporate priorities. The recent publication of the Scottish Government's five-year financial strategy provides scope to further develop medium and longer term financial planning.

2017/18 financial position

41. The Statement of Financial Position summarises what is owned and owed by Scottish Natural Heritage. This shows taxpayers' equity – an accounting measurement of the amount invested that has continuing public benefit. It shows how much of this has arisen from the application of revenues and how much has resulted through changes over time in the value of physical assets.

42. Scottish Natural Heritage's 2017/18 gross expenditure totalled £49.3 million and was largely funded by Scottish Government grant-in-aid of £46.9 million. Other income sources are: external funding (£0.7 million) which includes partnership and grant income towards specific projects; income from activities (£1.2 million) which includes the provision of professional services and renting office space; and EU funding (£0.4 million).

43. The financial statements show that Scottish Natural Heritage has net assets of £24.5 million, an increase of £0.8 million from last year. This is largely attributable to a decrease in trade and other receivables (£0.2 million), and an increase in trade and other payables (£0.8 million) offset by an increase in cash and cash equivalents of £1.9 million. Further information on how these figures are made up can be found in the Cash Flow Statement and Notes 17 and 19 in the annual report and accounts.

Financial planning

44. The 2018/19 budget was considered by the Senior Leadership Team in January 2018, and approved by the Board as part of the 2018/19 Business Plan in March 2018. The agreed budget for 2018/19 of £46.2 million represents a decrease of £0.2 million (0.5%) over the 2017/18 original budget allocation.

45. Additional funding of £0.4 million has been allocated from the Scottish Government for specific projects, most notably The Conservation Volunteers (TCV) (£0.2 million) and a contribution to cover the costs associated with the former Chief Executive's new role in advising the Scottish Government (£0.1 million). It is anticipated that a further £9.5 million of funding will be allocated for restoration of peatland projects during 2018/19.

46. The financial impact of the lifting of the public sector pay cap has been included in the 2018/19 budget and the Senior Leadership Team has agreed to continue the previous vacancy management policy of only filling 20% of vacant posts. Some of the savings generated will be used to create new posts and recruit staff with the skills and experience needed to deliver the 2018-2022 Corporate Plan priorities.

Medium to long term financial planning

47. During the year, we updated our review of Scottish Natural Heritage's financial planning systems and our assessment of how effective they are in identifying and addressing risks to financial sustainability across the medium (two to five years) and long term (five to ten years).

48. Last year we reported that management considered the financial sustainability of the organisation over a five-year period as part of the refresh of the Corporate Plan 2018-2022. Scenario planning was used to consider alternative financial outlooks (ranging from 0 to 5% reduction in the Board's cash settlement). The impact on the baseline budget of each of these scenarios was then considered along with the potential implications for ongoing work, and the capacity of the organisation to take on new challenges and initiatives.

49. We recognise that Scottish Natural Heritage is mainly funded through Scottish Government grant-in-aid and this has traditionally been determined on an annual basis. The Scottish Government has recently published its five-year financial strategy and this, together with Scottish Natural Heritage's new Corporate Plan 2018-2022, provides an opportunity to further develop medium and long term financial planning.



Recommendation 1

Scottish Natural Heritage should continue to develop its financial planning models in order to identify and address risks to financial sustainability across the medium and longer term.

Workforce planning

50. We identified workforce capacity as a wider dimension risk in our Annual Audit Plan. During the first quarter of the year, internal audit reviewed progress against the Workforce Planning Programme actions and concluded that progress had been slow, with the majority of actions delayed or not yet started. As part of their *Corporate Governance* report, internal audit reported that significant progress had been made by the end of 2017/18 with the overall programme and three of the four workstreams now rated as green (on track). One workstream, Workforce Analysis, was rated as amber (minor slippage).

51. Scottish Natural Heritage's Workforce Plan 2018-2022 has recently been approved and complements the Corporate Plan: Connecting People and Nature covering the same period. The plan reports that the number of full-time equivalent staff employed by Scottish Natural Heritage has reduced by 25% since 2011 and predicts that further reductions totalling 20% will be required over the next five years due to reductions in grant-in-aid funding. Balancing this level of reduction against the skills and specialisms needed to deliver corporate priorities will prove challenging. Workforce planning has been recognised as a risk in the corporate risk register and the importance of fully and effectively implementing the Workforce Plan is also included in the 2017/18 Governance Statement.

EU withdrawal

52. There remains significant uncertainty about the detailed implications of EU withdrawal. It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- workforce – the extent to which changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour

- funding – the extent to which potential changes to funding flows are likely to affect the finances of the organisation and the activity that such funding supports
- regulation – the extent to which potential changes to regulation across a broad range of areas overseen at an EU level are likely to affect the activities of the organisation.

53. Scottish Natural Heritage has included two medium level risks associated with EU withdrawal in its risk register. These are the risk that, due to a lack of clarity on future policy, funding and legislative frameworks, resources are misdirected and that confusing messages are given to stakeholders and staff resulting in negative impacts on the natural environment. These risks are being managed through close engagement with the Scottish Government and other key contacts within the environmental sector. Regular reports are made to the Board and work is ongoing on organisational readiness, agricultural support and long-term planning.

Part 4

Governance and transparency



Main judgements

Scottish Natural Heritage has appropriate arrangements in place to support good governance, accountability and scrutiny.

Internal audit is effective and operates in accordance with the Public Sector Internal Audit Standards.

Scottish Natural Heritage reviewed its approach to accessibility, openness and transparency during the year. Plans are in place to enhance public engagement and raise awareness of the new Corporate Plan 2018-2022: Connecting People and Nature. The number of Board meetings has increased and these will continue to be held in public. Agendas and Board minutes will be published on the website but access to Board papers will be by request and at the discretion of the Chair. Audit and Risk Committee meetings continue to be held in private.

Governance arrangements

54. Scottish Natural Heritage's corporate governance framework is centred around the Board which is supported by three committees including the Audit and Risk Committee. 2017/18 saw significant changes to the leadership of Scottish Natural Heritage with the appointment of a new Board Chair in May 2017 and a new Chief Executive in October 2017. Two new Deputy Chairs have also recently been appointed from existing Board members. The Board met seven times during 2017/18.

55. Each year, the Audit and Risk Committee hold a self-assessment session to consider the collective performance of the committee and identify areas for improvement in the coming year. Recent changes in the membership of this committee, including the appointment of a new Chair, resulted in the self-assessment session being postponed until August 2018.

56. 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.

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.

Internal audit

57. Internal audit is provided by Scottish Natural Heritage's in-house internal audit team supported by a co-sourcing contract with BDO to provide specialist and additional resources as required. Audit arrangements are overseen by the Head of Internal Audit.

58. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an assessment of the internal audit function. Our review concluded that the internal audit service is effective, operates in accordance with the Public Sector Internal Audit Standards (PSIAS), and has sound documentation standards and reporting procedures in place. The Scottish Government's Internal Audit Directorate undertook an external peer review of the internal audit function during the year and confirmed that it operates in accordance with the PSIAS.

59. To avoid duplication of effort we place reliance on the work of internal audit wherever possible. In 2017/18 we considered internal audit report findings on governance arrangements, risk management, workforce planning, management agreements and cyber security arrangements as part of our wider dimension work.

Risk management

60. As part of our planning work we reviewed Scottish Natural Heritage's risk management arrangements and reviewed the risks identified during the year. Detailed reports outlining changes in risk are prepared on a quarterly basis and presented to the Audit and Risk Committee for discussion, challenge and comment. The corporate risk register is managed by the Senior Leadership Team and each business unit has its own risk register, which feeds into the corporate risk register. We also reviewed internal audit's report on the risk management system.

61. We concluded that Scottish Natural Heritage's risk management arrangements are effective and reporting arrangements are appropriate.

Governance Statement

62. HM Treasury's Financial Reporting Manual (the FReM) states that Scottish Natural Heritage must prepare an annual governance statement within the annual report and accounts. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the governance statement and provides assurances around the achievement of the organisation's strategic objectives.

63. The SPFM does not prescribe a format for the annual governance statement but sets out minimum requirements for central government bodies. Within Scottish Natural Heritage a range of assurances are obtained from a variety of sources throughout the organisation. The most significant of these being the completion, by all Heads of Service, of governance tables on a quarterly basis. Each year internal audit assesses the Board's corporate governance arrangements (including the governance tables) and prepares a detailed report to support the disclosures in the governance statement.

64. We concluded that the 2017/18 governance statement complies with the guidance issued by the Scottish Ministers and, based on our knowledge and work performed, presents a comprehensive picture of governance arrangements and matters.

Openness and transparency

65. 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. There are increasing public expectations for more openness and transparency reflected in, for example, Scottish Parliament enquiries.

66. Last year we commented that there was scope to enhance the transparency of the Audit and Risk Committee as meetings are held in closed session and no agendas, papers or minutes are published on the website. Our understanding is that the Board are still considering whether more transparency could be introduced through holding these meetings in public.

67. In January 2018, the Board reviewed its approach to public accessibility, transparency and openness, and agreed to revise its arrangements as follows to increase accessibility, transparency and openness:

- plans are in place to extend stakeholder engagement in 2018/19 to raise awareness of the new Corporate Plan 2018-2022: Connecting People and Nature. This includes individual Board members focussing on widening external opportunities to engage across areas of responsibilities agreed with the Chair
- the number of Board meetings will be increased from four to eight per annum. Board meetings will continue to be held in public although any member of the public wishing to attend a meeting must advise the Board of their intention to do so in advance
- Board agendas and agreed minutes will continue to be published on the Board's website but Board papers will no longer be routinely available on the website. Members of the public can request Board papers and these will be provided at the discretion of the Chair in discussion with the Chief Executive.

68. Meetings of the Scientific Advisory Committee and the Protected Areas Committee are generally held in public with agendas, papers and minutes being published on Scottish Natural Heritage's website. We understand that there have been issues with the website during the year resulting in some agendas and minutes not being available at the time of our review.

69. Audit Scotland has recently prepared guidance for auditors to consider when reviewing an organisation's approach to openness and transparency. We will use this guidance to review Scottish Natural Heritage's revised approach to openness and transparency as part of our wider dimension audit work in 2018/19.

Cyber security

70. 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.

71. Scottish Natural Heritage is actively strengthening its cyber resilience arrangements. Full compliance with Cyber Essentials was achieved in February 2018, and work is ongoing to achieve Cyber Essentials Plus accreditation by 31 March 2019. Scottish Natural Heritage has also volunteered to become a cyber catalyst to share knowledge and learning and assist in identifying practical solutions to key issues.

72. Internal audit reviewed the arrangements for cyber security during 2017/18 and concluded that they were satisfactory. Some areas for improvement were identified and an action plan has been agreed with management to address these. Compliance against the information security standard (ISO 27001) was last assessed in January 2017 and a further assessment is planned during 2018/19.

General Data Protection Regulation

73. The new General Data Protection Regulation (GDPR) came into force on 25 May 2018. This replaced the UK Data Protection Act 1998 (DPA). As a Regulation, all EU member states must implement it in the same way. GDPR sets out more requirements than the DPA and has introduced new and significantly changed data protection concepts.

74. GDPR introduces a wide range of new rights for individuals in respect of their personal data. These include the right to be forgotten, the right to object to certain processing activities and to decisions taken by automated processes. Failure to comply with new GDPR data handling arrangements could result in Scottish Natural Heritage incurring significant fines.

75. Internal audit reviewed progress with implementing GDPR as part of their *Corporate Governance* audit and concluded that progress had been much slower than expected. Extra staff were allocated to this task in the last quarter of 2017/18 and the customer contacts application system (a major store of GDPR sensitive information) was redeveloped to bring it in line with the new legal requirements.

76. Although internal audit assessed the likelihood of a material incident occurring as low, the reputational risk of non-compliance was recognised as a corporate risk and monitored regularly by the Senior Leadership Team, Board and the Audit and Risk Committee in the period to 25 May 2018.

Part 5

Value for money



Main judgements

Scottish Natural Heritage has an effective performance management framework in place which supports the achievement of value for money.

Performance management

77. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value. Where such requirements are not specified we may, in conjunction with Scottish Natural Heritage, agree to undertake local work in this area.

78. Scottish Natural Heritage's updated Corporate Plan sets out 13 key priorities under five strategic aims for 2017/18. This is supported by the 2017/18 business plan which lists 82 key deliverables for 2017/18.

79. Performance against these priorities is monitored quarterly by the Board. Performance reports use a traffic light system to report progress against each of the Corporate Plan priorities and key deliverables. The 2017/18 quarter 4 performance report highlights that, as at 31 March 2018, 10 of the 13 Corporate Plan outcome measures were completed or on track, 1 was rated as 'amber' (minor slippage) and 2 were rated as 'red' (major slippage or weak performance). In addition, 89% of the 82 key deliverables had been completed or were on track.

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 Scottish Natural Heritage has an effective performance management framework in place which supports the achievement of value for money and continuous improvement in the way services are delivered.

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

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. In 2017/18 several reports were published which are of direct interest to Scottish Natural Heritage. 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 summarises relevant Audit Scotland reports and bulletins and prepares 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 2017/18

2017/18 recommendations for improvement



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p>Financial Sustainability</p> <p>The Scottish Government has recently published its five-year financial strategy and this, together with Scottish Natural Heritage's new 2018-2022 Corporate Plan, provides an opportunity to further develop medium and long term financial planning.</p> <p>Risk</p> <p>Scottish Natural Heritage is unable to deliver on its medium and longer term corporate priorities.</p>	<p>Scottish Natural Heritage should continue to develop its financial planning models in order to identify and address risks to financial sustainability across the medium and longer term.</p> <p>Paragraphs 47 to 49</p>	<p>The Finance, Planning and Performance Team will continue to work on the financial planning models and the scenarios for the medium to longer term.</p> <p>Head of Finance, Planning and Performance</p> <p>By end of 2018/19.</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 our wider responsibility under the [Code of Audit Practice 2016](#).












Audit Risk	Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements		
<p>1 Risk of management override of controls</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 in order 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>2 Risk of fraud over income</p> <p>Scottish Natural Heritage receives a significant amount of income in addition to Scottish Government funding. The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud.</p>	<p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p>	<p>Our audit work did not identify any issues that would indicate the risk of fraud over income affecting the year end position.</p>
<p>3 Risk of fraud over expenditure</p> <p>ISA240 and the Code of Audit Practice require auditors to consider the risk of fraud over certain types of public sector expenditure. This includes grants and other claims made by individuals and organisations on the public purse. Scottish Natural Heritage incurs significant expenditure on grants and research and so there is an inherent risk of fraud over this expenditure.</p>	<p>Walk-through of controls over the processing and payment of grants.</p> <p>Substantive testing of grant expenditure.</p> <p>Final review of the National Fraud Initiative exercise to ensure that all recommended matches from the prior year have been investigated and concluded.</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>Our final review of the National Fraud Initiative exercise did not identify any issues and all recommended matches had been adequately investigated.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>4 Estimation and judgements</p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account area of non-current assets. This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Completion of 'review of the work of an expert' programme for the professional valuer.</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>5 Changes in key finance staff</p> <p>There have been a number of changes in finance staff responsibilities following the resignation of the capital accountant in August 2017. There is a risk that these changes will impact on the finance team's ability to deliver the accounts and working papers to the required quality and within the agreed timescale.</p>	<p>Liaise with key financial staff to assess any ongoing issues in respect of capacity and the impact these may have on the preparation of the financial statements.</p>	<p>Finance staff prioritised the key tasks required for the preparation of the financial statements. No issues were noted in respect of the delivery of the accounts, the quality of the working papers or the timeliness of the preparations (see also paragraphs 16, 17 & 34).</p>
<p>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</p>		
<p>6 Financial sustainability</p> <p>As part of the Corporate Plan 2017/22, SNH considered the financial sustainability of the organisation over a five-year period. Scenario planning was used to consider the impact of alternative financial funding settlements on the baseline budget along with the implications for ongoing work and SNH's capacity to take on new challenges and initiatives. Uncertainties over future financial settlements and additional financial pressures, such as the removal of the public sector pay cap, present risk to the Board's continued financial sustainability.</p>	<p>Review and assessment of additional scenario planning and the implications on SNH's capacity to deliver its objectives.</p> <p>Attendance at appropriate Board meetings to observe financial sustainability discussions.</p>	<p>We reviewed the detailed sustainability planning prepared in response to the alternative scenarios provided by the Scottish Government. We noted that the impact on individual portfolio areas and the capacity of Scottish Natural Heritage to deliver its objectives was reflected as part of these plans (see also Part 2 of this report).</p> <p>We did not attend a Board meeting to observe financial sustainability discussions during 2017/18. This activity will be undertaken in 2018/19.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>7 Workforce capacity</p> <p>Increasing financial pressures have led to an increase in the use of vacancy management as a means of balancing the budget. Good workforce planning is essential to ensure that SNH has the right people, in the right place, at the right time to deliver its objectives. Although progress has been made in developing workforce planning, workforce capacity remains a risk area for SNH.</p>	<p>Monitor progress in embedding workforce planning arrangements at SNH including review of internal audit's work in this area.</p>	<p>We reviewed internal audit's report on workforce planning, and note the recent approval of the Workforce Plan, covering the period 2018-2022, which has been aligned to the new Corporate Plan.</p> <p>The new Workforce Plan provides a more strategic approach to workforce planning and sets out how the Board plans to ensure it will have the right people, with the right skills, in the right place at the right time to deliver its corporate priorities.</p> <p>Workforce planning has been recognised as a risk in the corporate risk register and the importance of fully and effectively implementing the Workforce Plan was included in the 2017/18 Governance Statement.</p> <p>(see also paragraphs 50 and 51 above).</p>

Appendix 3

Summary of national performance reports 2017/18

		 2017/18 Reports	
		Apr	
		May	
Common Agricultural Policy Futures programme: further update		Jun	 Scotland's colleges 2017
		Jul	 NHS workforce planning
Self-directed support: 2017 progress report		Aug	
Equal pay in Scottish councils		Sept	
Transport Scotland's ferry services		Oct	 NHS in Scotland 2017
Local government in Scotland: Financial overview 2016/17		Nov	
		Dec	
		Jan	
Early learning and childcare		Feb	
Managing the implementation of the Scotland Acts		Mar	

Central Government relevant reports

[Common Agricultural Policy Futures programme: further update](#) – June 2017

[Transport Scotland's ferry services](#) – October 2017

[Early learning and childcare](#) – February 2018

[Managing the implementation of the Scotland Acts](#) – March 2018

Scottish Natural Heritage

2017/18 Annual Audit Report

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