

# Scottish Natural Heritage

Management Report 2019/20



 AUDIT SCOTLAND

Prepared for Scottish Natural Heritage

May 2020

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# Audit findings

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## Introduction

- 1.** This report contains a summary of the key issues identified during the interim audit work carried out at Scottish Natural Heritage (SNH). This work included documentation of the new cloud-based FUSION application and testing of its key controls to gain assurance over the processes and systems used in preparing the financial statements. We will use the results of this testing to determine our approach during the 2019/20 financial statements audit.
- 2.** Our responsibilities under the *Code of Audit Practice* require us to assess the system of internal control put in place by management. We seek to gain assurance that the audited body:

  - has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements
  - has systems of internal control which provide an adequate means of preventing and detecting error, fraud or corruption
  - complies with established policies, procedures, laws and regulations.
- 3.** In addition, we carried out early substantive testing on material account areas including income, expenditure and staff costs
- 4.** The *Code of Audit Practice* also requires that we undertake work on the wider dimensions which frame the wider scope of public sector audit requirements. Our interim work focussed on SNH's preparations for the implementation of IFRS16 Leases, and its arrangements for preventing fraud in procurement and responding to the National Fraud Initiative.
- 5.** Any weaknesses identified represent those that have come to our attention during the course of normal audit work and, therefore, are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to Scottish Natural Heritage.
- 6.** The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.
- 7.** All our outputs and any matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

## Conclusions

- 8.** Overall, we found that the majority of the key controls within SNH's main financial systems were operating satisfactorily. We identified three weaknesses in key controls, two of which (delays in completion of key reconciliations, and the non-completion of quarterly review of journal entries) were due to the impact of the implementation of the new FUSION application. We concluded that the remaining control weakness (lack of evidence of project progress being obtained before a grant payment was made) was an isolated incident. Further information on these control weaknesses is set out in paragraph 15 below together with the impact on our approach to the audit of the 2019/20 financial statements.

**9.** No issues arose from our interim substantive testing of income, expenditure and staff costs.

**10.** In terms of our ‘wider dimension’ audit work we concluded that SNH:

- has undertaken extensive preparatory work in preparation for the introduction of IFRS16 Leases with effect from 1 April 2021
- has arrangements to mitigate the risk of fraud in procurement activities but needs to do more to ensure that staff responsible for leading procurement activity totalling less than £50,000 are appropriately trained
- was pro-active in investigating National Fraud Investigation matches and conducting the appropriate investigations, although implementation of the new FUSION application meant progress was slower than in previous years. No frauds or errors were found.

## Main financial systems

### Work done

**11.** During 2019/20, SNH implemented a new cloud-based finance application – FUSION. Originally scheduled for 01 April 2019, the finance module of the application did not ‘go-live’ until June 2019 with the HR and payroll modules delayed until October 2019. This impacted on our audit approach as there were two financial applications in operation during 2019/20.

**12.** As part of our interim work we reviewed the new FUSION application to understand its operation and the controls in place. Once we had documented the system we completed:

- walkthroughs of the key controls identified for each of SNH’s main financial systems (general ledger, payroll, cash & bank, accounts payable and accounts receivable)
- testing of the key controls in operation within these systems including reconciliations, controls over IT access and changes to standing data, and the controls in place to prevent and detect fraud in respect of grant payments
- initial substantive testing of income, expenditure and some elements of staff costs covering the first nine accounting periods of the 2019/20 year. Additional substantive testing will be undertaken as part of our audit of the 2019/20 financial statements.

**13.** We also reviewed the controls in place over the transfer of opening balances and transactions from the previous E-Business suite to FUSION.

**14.** In accordance with *ISA 330: the auditor’s response to assessed risk*, we have confirmed our understanding of the key controls in operation within the previous application, completed a walkthrough and relied on prior year testing of key controls where these remained unchanged and there were no significant weaknesses identified in previous years.

### Audit findings

**15.** Overall, we found that the majority of the key controls within SNH’s main financial systems were operating satisfactorily. We identified three control weaknesses which are reported below together with the impact on our approach to the audit of the 2019/20 financial statements:

- **delays in the completion of key reconciliations:** last year we reported delays in the completion of key reconciliations due to the additional work resulting from the implementation of the new FUSION application. Our

interim testing found that these delays continued during 2019/20 until October 2019.

**Impact on our audit approach:** there is no impact on our audit approach as reconciliations have been brought up to date and have been completed timeously since October 2019. We will substantively test the year-end reconciliations as part of our standard final accounts audit procedures

- **non-completion of quarterly check of all journal entries:** finance team members can post journals without authorisation. As a mitigating control, the Financial Accountant performs a quarterly check of all journals and queries any unusual entries. At the time of our audit visit (February 2020), these checks had not been undertaken in 2019/20 due to the additional work resulting from the implementation of the new FUSION application.

**Impact on our audit approach:** we have been advised that these checks will be completed as part of the preparation of the annual report and accounts. We will review these as part of our final accounts audit. If these checks are not completed, we will increase the number of journal entries that we substantively test as part of our final accounts audit

- **controls over grant payments:** the Business Planning system was unavailable for 1 week during August 2019 and as a result funding officers were unable to create highlight reports to record project progress in support of grant payments. Instead, file notes were generated outwith the system and saved to the Electronic Records and Data Management System (ERDMS) and subsequently added to the Business Planning system. Our walkthrough of the controls over grant payments found that there was no file note for the payment selected and thus no record of progress on the project to support the grant payment made (£6,977).

**Impact on our audit approach:** we extended our sample to include the remaining (2) grant payments made in the period the Business Planning system was unavailable and both had the file note attached. We have, therefore, concluded that this is an isolated incident. Testing of other weeks concluded that the controls over grant payments were operating satisfactorily.

**16.** As part of our documentation of the new FUSION application we were alerted to an issue with how the new payroll module calculated employer pension contributions for certain employees (those with mid-month changes to their pensionable salary). This issue was picked up by the controls operated by SNH's payroll staff and manually corrected before the payroll was run. A 'patch' was provided for the module in February 2020. SNH payroll staff have confirmed that this has fixed the issue and the payroll module is now correctly calculating employer pension contributions.

**17.** There were no issues identified during our early substantive testing of expenditure, income and staff costs. We will carry out further substantive testing during our year-end financial statements work, focusing on transactions in the latter part of the financial year. This is part of our normal audit process and will build on the work reported here.

**18.** In line with good practice, officers provided regular updates to the Audit and Risk Committee on the progress of the FUSION project. The most recent of these, as at February 2020, noted that delaying the 'go-live' date, together with the additional time needed to resolve payroll and MyCSP issues identified following implementation, increased the project costs by 13%. A 'Lessons Learned' report will be submitted to a future meeting of the Audit and Risk Committee and a post-implementation review is scheduled for 2020/21. We review these reports as part of our ongoing audit activity.

## **Wider dimensions**

**19.** We identified two wider dimension risks in our 2019/20 Annual Audit Plan. The findings from our review of preparations for the introduction of IFRS16 Leases is reported below. Our work on financial sustainability is ongoing and will be reported in our 2019/20 Annual Audit Report.

**20.** In addition, we have undertaken work on financial management (arrangements for preventing fraud in procurement and responding to the National Fraud Initiative). Work on governance and transparency (arrangements for compliance with the Equalities Act 2010) is ongoing and will be reported in our 2019/20 Annual Audit Report.

## **Preparations for the introduction of IFRS16 Leases**

**21.** The 2019/20 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. In our 2019/20 Annual Audit Plan we noted that early work would be required to assess the practical implications and to ensure arrangements were in place to support adoption of this IFRS.

**22.** Our interim audit work found that SNH has undertaken extensive preparatory work including 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 aid the management of leases under IFRS16.

**23.** In response to COVID-19, the Financial Reporting Advisory Board (FRAB) agreed, in March 2020, to delay the implementation of IFRS16 until 01 April 2021. We will continue to monitor SNH's preparations for the implementation of IFRS16 Leases for the remainder of our audit appointment.

## **Arrangements for preventing fraud in procurement**

**24.** As part of our 2019/20 audit, we reviewed how SNH manages the risk of fraud in its procurement activities. Our review confirmed that SNH has a number of controls in place to mitigate this risk including:

- a range of appropriate policies, such as the staff code of conduct, procurement strategy, fraud policy and response plan, and whistleblowing policy
- use of the Public Contracts Scotland portal, by the procurement team, for any contracts in excess of £50,000
- appropriate training for the procurement team to help them identify any potential fraud
- retrospective compliance checks are undertaken by the procurement team on a sample of contracts under £50,000, which are led by project managers with Delegated Financial Authority, to ensure correct purchasing procedures were followed with corrective actions undertaken if required
- internal audit considers the risk of fraud in procurement as part of its annual audit plans. For example, the 2019/20 plan includes consideration of fraud in procurement, grants and management agreements as part of the Conflict of Interests audit.

**25.** SNH takes part in the Procurement and Commercial Improvement Programme (PCIP) assessment undertaken by the Scottish Government Procurement Capability team. The latest assessment, as at October 2019, found that SNH 'has a robust approach to fraud and there have been no red flags from the last three year's internal audits.' The review noted, however, that 96% of SNH's procurement activity is undertaken by project managers outwith the procurement team and that the training of these staff relies on them reading documents. The review made a number of recommendations including:

- refreshing procurement guidance and invitation to tender documents
- strengthening the approach to internal training for staff with Delegated Financial Authority who will lead a procurement project, rather than relying on retrospective compliance checks
- accelerating the upload of procurement e-learning modules onto SNH's e-learning platform. We have been advised that two new e-learning packages on procurement were added to the FUSION learning module in November 2019. These cover contract & supplier management (three sessions), and contract tender evaluation & scoring.

**26.** We concluded that SNH has arrangements in place to mitigate the risk of fraud in procurement activities but needs to do more to ensure that staff responsible for leading procurement activity totalling less than £50,000 are appropriately trained. Work is ongoing within SNH to action the PCIP recommendations.

**27.** In October 2019, Audit Scotland and Police Scotland published a report 'Red Flags: Procurement' which highlights risks in procurement activity and the controls that can help to prevent fraud. This report has recently been added to SNH's procurement intranet site which is accessible to all staff involved in procurement activity.

**28.** During this audit, we were alerted to concerns that work done by third parties as part of some of the smaller Peatlands Action projects may not be subject to the same procurement processes as those used by SNH. We discussed this with SNH's funding team, and they confirmed that they are aware of the risk and are implementing a number of mitigating actions. We also alerted the Head of Internal Audit who has agreed to consider including this area as part of the 'Delivery of the Climate Change Peatland project' audit planned for 2020/21. The amounts involved are not material to our opinion on the 2019/20 financial statements and so there is no impact on our audit approach.

### **Response to the National Fraud Initiative**

**29.** 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.

**30.** The online application identifies high risk cases although it is up to individual bodies to decide which, and how many, matches to investigate. Our review of the system, as at 11 February 2020, noted that 91 out of SNH's 112 high risk matches had been investigated. One report containing high risk matches had initially been missed but these have since been reviewed.

**31.** The approach to investigating matches is unchanged from prior years and we are satisfied that SNH was pro-active in reviewing matches and conducting the appropriate investigations, although implementation of the new FUSION application meant progress was slower than in previous years. In total, 149 (20%) of SNH's 746 matches were reviewed with the decision to review based on the risk level of the match. No frauds or errors were found. A report on the results of the NFI exercise will be submitted to the next meeting of the Audit and Risk Committee.

# Scottish Natural Heritage

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