

Scottish Environment Protection Agency

Report on the 2007/08 Audit



September 2008



Contents

Executive Summary	1	Governance	7
Introduction	3	Performance Management	10
Financial Position	4	Looking Forward	14



Executive Summary

Introduction

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

Financial Position

SEPA achieved a surplus of £3.134 million in 2007/08. This is the difference between the deficit for the year of £35.211 million and the funding received from the Scottish Government of £38.345 million. SEPA utilised this surplus to fund its capital expenditure. SEPA operated within the budget limits set by the Scottish Government for capital expenditure and operating expenditure.

Scottish ministers have agreed a resource budget of £82.92 million for 2008/09 with £34.54 million of this funded from income from charging schemes and other income and the remaining £48.38 million to be funded by the Scottish Government. The total resource budget has been allocated with £72.52 million for operating expenditure and £10.4 million for capital expenditure. SEPA is predicting a balanced budget for 2008/09 and 2009/10 and a £2.1million deficit in 2010/11. SEPA are currently developing plans to identify further savings to eliminate this deficit. This represents a significant challenge to the organisation.

Financial Statements

We have given an unqualified opinion on the financial statements of SEPA for 2007/08.

We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

Performance

SEPA's original targets under the Efficient Government Plan for the three years to 2008/09 were £2.0 million of cash-releasing efficiencies and £2.1million of time-releasing efficiencies. The actual efficiency savings achieved to 31 March 2008 were £2.8 million of cash-releasing and £2.2 million of time-releasing efficiencies. Future efficiency savings are set at 2% per annum, as part of the budget settlement from the Scottish Government for the next three years. The delivery of these efficiency savings together with other budget pressures in the medium term are a significant challenge for SEPA.

SEPA has a target of full cost recovery on chargeable services. These include services provided under the Control of Major Accident Hazards Regulations and Water Environment and Water Services Act. In 2007/08 SEPA achieved 96% cost recovery across all the charging schemes (2006/07: 97%).



SEPA met 18 out of 23 key targets for 2007/08 including responding to 95% of environmental complaints within 24 hours and meeting the Water Framework Directive environmental monitoring network requirements. SEPA narrowly missed the cost recovery and the waste compliance target and failed to achieve the bathing waters target and two water targets. The bathing target of 100% compliance for designated bathing waters was missed due to coastal areas experiencing the wettest summer for over 30 years

The corporate plan for 2008 – 2011 was published in August 2008. The plan focuses on seven key areas including limiting and adapting to climate change and reducing waste and promoting sustainable use of resources. Within each area SEPA has set proposed key actions along with timescales..

Best Value

SEPA completed a baseline review of its best value arrangements in 2005/06. Since that time SEPA completed best value reviews of its finance and communications functions and a review of analytical services is ongoing. The finance and communications reviews have both led to the restructuring of services. In 2008/09 SEPA intends to review the delivery of the national waste strategy and carry out an organisational wide best value review.

Governance

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. Overall the corporate governance and control arrangements for SEPA operated satisfactorily during the year, as reflected in the Statement on Internal Control.

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

Looking forward

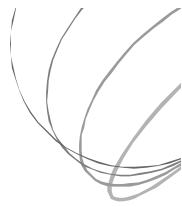
The final part of our report notes some key risk areas and issues for SEPA going forward. We highlighted a number of national issues which affect all public sector bodies including SEPA, including the National Performance Framework and the introduction of Scotland Performs; the impact of international financial reporting standards; and the review of data handling arrangement in public bodies across Scotland. SEPA also faces significant financial pressure over the next three years to achieve financial balance. We will continue to monitor financial planning arrangements and SEPA's financial position.

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



Introduction

1. This report summarises the findings from our 2007/08 audit of SEPA. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 18 December 2007. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued a range of reports this year, and we briefly touch on the key issues we raised in this report. Each report set out our detailed findings and recommendations and the Board's agreed response.
3. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of SEPA during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk.



Financial Position

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

Our responsibilities

5. We audit the financial statements and give an opinion on:
 - whether they give a true and fair view of the financial position of SEPA and its expenditure and income for the period in question;
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements;
 - the consistency of the information which comprises the Directors Report, Statutory Background, Principal Activities, Financial Performance, Capital Investments in Year, Gifts and Charitable Donations, Losses, Special Payments and Write Offs, Supplier Payments Policy, European Monetary Union, Auditors and Professional Advisors, with the financial statements, and
 - the regularity of the expenditure and receipts.
6. We also review the statement on internal control by:
 - considering the adequacy of the process put in place by the chief executive as accountable officer to obtain assurances on systems of internal control, and
 - assessing whether disclosures in the statement are consistent with our knowledge of SEPA.

Overall conclusion

7. We have given an unqualified opinion on the financial statements of SEPA for 2007/08.
8. As agreed the unaudited accounts were provided to us on 23 May 2008, supported by a working paper package. We concluded our audit within the agreed timetable and provided our opinion to the Audit Committee on 26 June 2007 as timetabled.



Financial Position

Outturn 2007/08

9. SEPA is required to work within its resource budget set by the Scottish Government. SEPA is expected to ensure that, taking one year with another, income from Grant in Aid and charging schemes, equals expenditure. For 2007/08 SEPA had a surplus of £3.134 million.. This is the difference between the deficit for the year of £35.211 million and the funding received from the Scottish Government of £38.345 million. This surplus was used to fund capital expenditure.
10. SEPA's balance sheet at 31 March 2008 shows net assets of £14.955 million (2006/07 net liabilities of £8.274 million). The movement is mainly caused by the reduction of the deficit on the pension liability, which has decreased by £18.426 million. The decreased deficit is due to increase in the discount rate from 2.1% to 3.2% the actuary uses to calculate the pension liabilities at the year end.
11. SEPA operated within the budget limits set by the Scottish Government for capital expenditure, and operating expenditure. – see exhibit 1 below:

Exhibit 1 – Performance against budget 2007/08 (£ million)

Limits	Budget	Actual Outturn	Difference
Capital Expenditure	3.651	3.652	0.001
Operating Expenditure	36.961	36.931	(0.030)
Total	40.612	40.583	(0.029)

2008/09 Budget

12. Scottish Ministers have agreed a resource budget for SEPA of £82.92 million for 2008/09. This comprises operating expenditure of £72.52 million and capital expenditure of £10.4 million.
13. This is to be funded as follows:

Exhibit 2 – 2008/09 Resource Plan

Limits	Budget
	£million
Grant in Aid	48.38
Charging Schemes	33.97
Other Income	0.57
Total	82.92



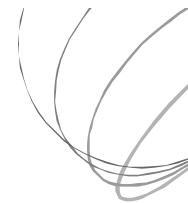
14. SEPA is expected to achieve 2% of efficiency savings per year from 2008/09 to 2010/11 and grant in aid will not be uplifted for pay or general inflation as this is expected to be met from SEPA's efficiency savings each year. Although SEPA has forecast a balanced budget for 2008/09 and 2009/10 a £2.1 million deficit has been forecast for 2010/11. Delivering efficiencies year on year while absorbing pay inflation and other cost pressures represents a significant challenge for the organisation
15. Capital expenditure is planned to increase significantly in 2008/09, by £6.7 million to £10.4 million. This increase is mainly due to the cost of an office development in Aberdeen. SEPA receives specific funding from the Scottish Government for larger capital projects.

Issues arising from the audit

16. As required by auditing standards we reported to the audit committee in 25 June 2008. There were no issues that required to be brought to the attention of the audit committee.

Regularity Assertion

17. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.



Governance

Overview of arrangements

18. This section sets out our main findings arising from our review of SEPA governance arrangements.

This year we reviewed:

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

19. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position (see paragraphs 9-11). Our overall conclusion is that arrangements within SEPA are sound and have operated through 2007/08.

Corporate Objectives

20. SEPA published its corporate plan for 2008 – 2011 in August 2008. The plan focuses on seven key areas:

- An efficient, effective and enabling SEPA.
- Limiting and adapting to climate change;
- Protected human health and communities;
- Reduced waste and promoting sustainable use of resources;
- Improved air quality;
- Improved land quality with healthier soils; and
- Improved water environments.

21. Within each area SEPA has set proposed key actions along with timescales. SEPA will have to keep targets under review to ensure achievement of key actions. The delivery of the corporate plan objectives will be particularly challenging given the tight financial constraints over the same period. This is an area we will keep under review during our appointment.

Strategy

22. In June 2007 Ministers challenged the organisations delivering the rural affairs and environment portfolio to create a single environment and rural delivery service (SEARS). During 2007 the



organisations involved developed proposals and implemented phase one. Phase one includes co-ordinated inspection, single customer register and single door entry. The SEARS project was officially launched on 20 June 2008. Options for the development of phase two are currently being considered. We will continue to monitor progress on this during 2008/09.

Systems of internal control

23. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In their annual report for 2007/08 KPMG, the internal auditors, provided an opinion that based on the internal audit work undertaken during the year, SEPA's systems provide an adequate basis for maintaining control and that the control framework provides adequate assurance regarding the effective and efficient achievement of the objectives of SEPA.
24. As part of our audit we reviewed the high level controls in a number of SEPA's systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively and there were no issues from our work which merited disclosure within the Statement on Internal Control in the 2007/08 accounts.
25. During the year SEPA completed a review of the annual charges for the Water Environment Services charging scheme (which is SEPA biggest scheme). The review highlighted that there were some license data inconsistencies which had lead to over and under charging for some customers. Appropriate action has been taken by SEPA and there was no material effect on the financial statements. SEPA have carried out various checks to ensure that 2008/09 bills are correct. Other charging schemes will be reviewed in 2008/09 to ensure that information and billing is correct. SEPA have made a disclosure regarding this issue within the statement on internal control.

Prevention and detection of fraud and irregularities

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

Internal Audit

27. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2007/08 audit we assessed whether we could place reliance on SEPA's internal audit function. We concluded that the KPMG operates in accordance with the Government Internal Audit Manual and therefore placed



reliance on their work in number of areas during 2007/08, as we anticipated in our annual audit plan.

Statement on Internal Control

28. The Statement on Internal Control provided by SEPA Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out SEPA's approach to this.

Information and Communication Technology

29. The planned Your Business at Risk report and the follow up of the computer service review client questionnaire carried out in 2006/07 will be carried out in the autumn 2008 once actions have been completed.

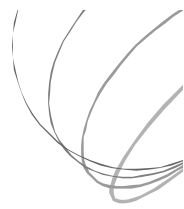


Performance Management

30. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
31. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

Best Value developments

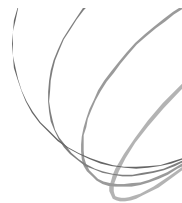
32. The positive impact of the Best Value concept in local government led Scottish Ministers to introduce a non-statutory Best Value duty on all public sector accountable officers (i.e. across health and central government) in 2002. This was reinforced by refreshed Ministerial guidance in 2006, highlighting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



37. SEPA completed a baseline review of best value in 2005/06. Since that time best value reviews were completed on finance and communications and a review is underway on analytical services. Both the finance and communications review led to restructuring of the services and to efficiencies being identified. The implementation of these changes will be reviewed and outcomes will be reported.
38. During 2008/09 a best value review of the national waste strategy will be completed. This has been subject to a substantial commitment from the Scottish Government and the review should ensure that SEPA is capable of meeting the new challenges in this area. SEPA is also committed to carrying out an organisation wide best value review which will be benchmarked against the review completed four years ago.

Efficiency

39. SEPA's target for the Efficient Government Plan for the three years to 2008/09 were £2 million of cash-releasing savings and £2.1 million of time-releasing efficiencies. The actual savings achieved to 31 March 2008 were £2.8 million of cash releasing and £2.2 million of time releasing efficiencies.
40. In the next three years budget settlement SEPA is required to make a 2% per annum cash releasing efficiency savings and absorb pay and cost inflation. The 2% efficiency represents in the region of £0.7 million per annum. However to achieve balanced budgets SEPA requires to make a total saving of £2.7 million to meet its balanced budget in 2008/09 and 2009/10. As mentioned previously £2.1 million savings are required in 2010/11. The combined savings over the next three years are significantly greater than the 2% target set by the Scottish Government. These will be challenging targets for SEPA to achieve.
41. SEPA has highlighted the following risks to achieving financial balance:
 - The pay provision may not meet the cost arising from equal pay, job evaluation and pay band restructuring.
 - The Aberdeen office development may slip and the Scottish Government may not allow funds to be carried forward.
 - Charging scheme income may change which will have an effect on the staffing levels required to support the schemes.
 - The impact of the SEARS project on finances if support functions are undertaken by other bodies.
42. We will continue to monitor the financial position and the actions taken by SEPA to manage these risks.



Performance Management

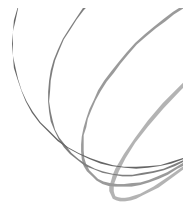
43. SEPA has a target of full cost recovery on chargeable services. In 2007/08 SEPA achieved 96% cost recovery across all the charging schemes (2006/07: 97%). Full costs were not recovered for five of the schemes and the most significant (£1.3 million) under recovery was in relation to the Pollution Prevention & Control (PPC) scheme. The under recovery is mainly due to additional time spent processing an abnormally high level of applications to meet a PPC directive requirement of processing all applications by October 2007.
44. SEPA are responsible for the regulation of activities that may pollute water, air, land, storage, transport and disposal of waste; and keeping and disposal of radioactive materials. These responsibilities have been interpreted into six high level outcomes which are: minimised, recovered and well managed waste; good water environments; good air quality; good land quality; a respected environment; and economic well being. SEPA have set key targets covering these outcomes.
45. The Agency Board regularly reviews SEPA's performance against the corporate plan through quarterly performance reports. The reports are discussed in Board meetings and continuous development is taking place to improve the format of the report. Targets on red status are followed up and action taken and reported to resolve any issues.
46. SEPA met 18 out of 23 key targets for 2007/08 including responding to 95% of environmental complaints within 24 hours and meeting the Water Framework Directive environmental monitoring network requirements. SEPA narrowly missed the cost recovery and the waste compliance target and failed to achieve the bathing waters target and two water targets. The bathing target of 100% compliance for designated bathing waters was missed due to coastal areas experiencing the wettest summer for over 30 years.

National Studies

47. Audit Scotland published one national study relevant to SEPA. This report was Sustainable Waste Management and was published in September 2007.

Sustainable Waste Management

48. The overall aim of study was to review the work of councils, SEPA and the Scottish Government in reducing the amount of waste being sent to landfill and to make recommendations to improve the economy, efficiency and effectiveness of waste management. The key findings were as follows:
 - significant progress has been made in meeting interim recycling targets but increasing the recycling rate will provide great challenges;



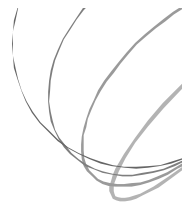
- there has been slow progress in developing residual waste treatment facilities thus there is a significant risk that Landfill Directive targets will not be met;
 - the increase in the amount of recycling has led to increased costs. This inevitable limits the economic viability of recycling schemes; and
 - the Scottish Government, local authorities and other agencies need to work more effectively together to make rapid progress in waste minimisation, recycling and waste treatment to achieve the Landfill Directive targets.
49. SEPA has also contributed to the Audit Scotland study: 'Promoting and improving energy efficiency in the public sector'. This study will review how well the public sector is promoting and improving energy efficiency across their estates. A number of issues will be examined including the approaches taken to improving energy efficiency; Performance against energy objectives and targets; and the extent to which the public sector demonstrates continuous improvement in relation to energy efficiency. This report is due to be published in December 2008.



Looking Forward

50. SEPA faces a number of challenges in 2008/09, which include:

- **International Financial Reporting Standards (IFRS)** – As part of the UK Budget 2007 the Chancellor announced that the timetable for IFRS implementation was to be extended by a year with central government accounts in Scotland to become IFRS compliant with effect from the 2009/10 financial year. The Scottish Government have notified central government bodies that they will be required to produce shadow IFRS based accounts for the financial year in 2008/09, including a restated balance sheet as at 1 April 2008. A detailed timetable and list of requirements has been issued by the Scottish Government. This process will require resource to complete and it will be important that the restatement is tackled early in 2008/09, with a plan in place to manage the transition.
- **Scotland Performs** – The Scottish Government is continuing to develop its approach to performance management based on the National Performance Framework and local authority single outcome agreements. The National Performance Framework is an outcome-based approach that is publically reported on the Scottish Government's web site in the 'Virginia-style' model of performance measurement and reporting.. This will include progress on overall delivery of the administration's purpose for Government, the five strategic objectives for Scotland and other aspects of the outcomes based National Performance Framework. We will consider how SEPA is addressing this developing area as part of the 2008/09 audit.
- **Efficiency and future funding** – Budgets for 2008/09 and the immediate future will need to be managed within a tighter funding regime. This includes no scope for the application of end of year flexibility for the Government with HM Treasury until the next Spending Review; no option to transfer funds from capital to revenue; and the impact of the introduction of International Financial Reporting Standards (IFRS), particularly on PFI, leases and infrastructure accounting. SEPA needs to find £4.8 million of savings over the next three years to achieve financial balance. The challenge for SEPA is to prioritise spending, identify efficiencies and review future commitments to ensure delivery of key targets and objectives.
- **Data handling** – The Scottish Government carried out a review of data handling arrangements in Scotland, in response to failures in UK government bodies procedures and practices during 2007. The review considered current policies and procedures on data protection, consistency with government standards and local arrangements for implementation of procedures. An interim report published in April 2008 made some initial recommendations and a final report is expected soon. We will monitor SEPA's response to the review and action taken as part of our 2008/09 audit.



- **Single environment and rural service (SEARS)** – SEARS was launched on 20 June 2008. The implementation of SEARS has a phased approach and phase one is currently being implemented. Phase one includes co-ordinated inspection, single customer register and single door entry. Options for delivery of phase two of the strategy are currently being considered. SEPA will continue to have a key role in developing the service and this will be a challenge over the coming year.
- **Corporate plan 2008 -2011** – SEPA published its corporate plan in August 2008 for the next three years. The corporate plan includes key actions and timescales. We will continue to review SEPA's performance against these targets and how this is reported.