

Scottish Environment Protection Agency

Report on the 2009/10 Audit to Scottish Environment Protection Agency and the Auditor General for Scotland

October 2010

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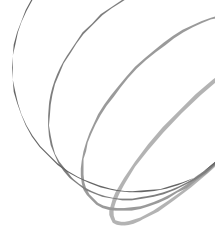
AUDIT SCOTLAND

Scottish Environment Protection Agency

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Key messages

In 2009/10 we looked at the key strategic and financial risks being faced by the Scottish Environment Protection Agency (SEPA). We audited the financial statements and reviewed the use of resources and aspects of performance management and governance. This report sets out our key findings.

Financial statements

We have given an unqualified opinion on the financial statements of SEPA for 2009/10. 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.

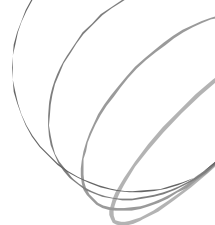
Financial position and use of resources

Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight. It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known. Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the smaller budget available. In the current economic climate difficult decisions will have to be made across the public sector about priority spending programmes.

In April 2009 SEPA published its Annual Operating Plan 2009 - 2010 which set out change programmes driven by a number of factors including the current economic climate and changes in public sector priorities and funding. This has enabled SEPA to implement an organisational restructure, including the use of a voluntary severance exercise at the start of 2010 which resulted in 71 posts being removed from the staffing establishment at a cost of £3.136 million resulting in annual savings of £2.581 million. The scheme was approved and funded by the Scottish Government. In addition, 50 further frozen and unoccupied posts were deleted from the staffing establishment.

SEPA operated within the resource budget limits for 2009/10 set by the Scottish Government for cash expenditure and non cash costs. SEPA was unable to operate within the capital expenditure budget. The £0.750 million overspend arose due to SEPA spending the funding that was contributed by Scottish Natural Heritage for the construction of Inverdee House. The annual budget allocation provided by Scottish Government was not increased to reflect this additional resource however SNH is within the same Scottish Government portfolio as SEPA and the Scottish Government has confirmed that this overspend would be managed at portfolio level.

During 2009/10 the major capital project to build Inverdee House was completed. SEPA recorded a £5.079 million write off within the 2009/10 financial statements in relation to this project. This write off represented



the difference between the capital expenditure incurred and the valuation provided by professional valuers to meet IFRS requirements. In addition the actuarial valuation of the pension scheme carried out in accordance with IFRS resulted in a non-cash pension adjustment of £2.389 million. SEPA has no annual managed resource limit to cover these costs and the Scottish Government have confirmed that this will be managed at portfolio level.

Within the annual operating plan the budget for SEPA is £77.991 million for 2010/11. This comprises operating expenditure of £74.991 million and capital charges of £3 million.

SEPA had a cumulative cash efficiency target of £1.455 million set by the Scottish Government for the two years to 31 March 2010. SEPA achieved savings of £4.974 million over that period. SEPA's 2010/11 budget, which was agreed by the Agency Board in April 2010, incorporates £3.6 million of efficiency savings which exceeds the Scottish Government target of £1.21 million. The 2010/11 budget utilises these efficiency savings to meet known cost pressures including pay inflation and pension increases. It also contains a detailed risk analysis which recognises the financial uncertainties facing SEPA specifically and the public sector in general. SEPA must continue to manage these financial challenges, through the planned change programmes, to enable it to achieve its key performance targets.

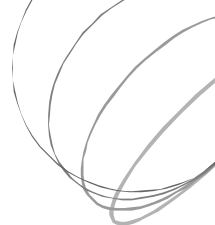
Governance and accountability

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 the financial systems and procedures operated sufficiently well to enable us to place reliance on them.

Performance

The Annual Operating Plan 2009 – 2010 set out how the aspirations within the corporate plan would be delivered. A key aspect of the plan was an organisational change programme which provided a framework for reviewing how SEPA operates. SEPA has produced an annual operating plan for 2010/11 which builds on the significant change programme introduced in 2009/10 and it aims by 31 March 2011 to have implemented significant elements of the step change in science programme and designed a credible affordable better regulation regime for environmental advice, licensing and enforcement. The total number of outcomes has been reduced to reflect the need to focus on delivering key priorities. The tight financial constraints mean that the delivery of these key priorities will be challenging however SEPA is well placed given the actions already taken.



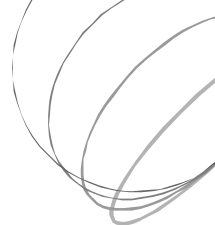
For 2009/10 SEPA has met 18 of its 20 key targets, including exceeding the Scottish Government's efficiency target and delivering corporate objectives within budget. The 2 remaining targets were changed to reflect SEPA's current operating regime. The target to prioritise service reviews with the aim of reducing costs by 10% was superseded by the change programme. The other target of ensuring 92% permit compliance for Pollution Prevention and Control Installations, was superseded by SEPA concentrating on ensuring compliance with the new scheme which was introduced in January 2009.

Looking forward

The final part of our report notes some key risk areas and issues for SEPA going forward. SEPA faces significant financial challenges and we will continue to monitor SEPA's financial position and the achievement of efficiency savings. We also highlight national issues which affect all public sector bodies including SEPA.

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

Audit Scotland
October 2010

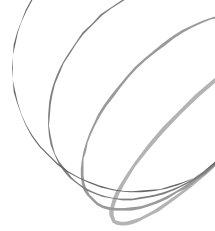


Introduction

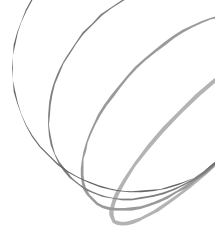
1. This report summarises the findings from our 2009/10 audit of SEPA. The scope of the audit was set out in our Annual Audit Plan in accordance with the Code of Audit Practice, which was presented to the Audit Committee on 15 December 2009. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued reports during the year, and we briefly touch on any issues raised within this report. Each report set out our findings and recommendations and SEPAs response.
3. Best value duties apply across the public sector and are a formal duty on all accountable officers. Audit Scotland has adopted a generic framework for the audit of best value across the public sector and this has been further developed during 2009/10 with the completion of its bank of best value Toolkits which, although primarily designed for audit use, are available to all public bodies for reference.

Exhibit 1: Framework for a best value audit of a public body





4. A linked development here has been the Scottish Government's work to refresh its 2006 best value Guidance for Public Bodies. This latter initiative, due for issue later in 2010, will result in clearer guidance to public bodies, and particularly those in the Central Government and Health sectors, on securing continuous improvement in performance, with due regard to the balance between cost and quality.
5. Throughout this report we comment on aspects of SEPA's arrangements in this area. Our comments are made on the basis of information made available in the course of the annual audit. We do not make an overall best value judgement because we do not yet have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time. This report represents a further step towards that goal.
6. Another building block for our assessment of best value is the national study programme carried out by Audit Scotland on behalf of both the Auditor General for Scotland and the Accounts Commission. Where these have a bearing on the activities, risks or performance of SEPA, we make reference to these reports in this document. Full copies of the study reports can be obtained from Audit Scotland's website, www.audit-scotland.gov.uk.
7. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by management 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.



Financial Statements

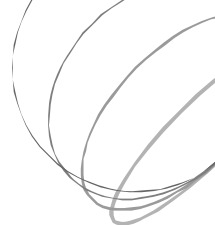
8. In this section we summarise key outcomes from our audit of SEPA's financial statements for 2009/10 and the accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

9. 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 within the financial statements;
 - the regularity of the expenditure and receipts.
10. 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;
 - assessing whether disclosures in the statement are consistent with our knowledge of SEPA.

Overall conclusion

11. We have given an unqualified opinion on the financial statements of SEPA for 2009/10.
12. As agreed the initial version of the unaudited accounts were provided to us on 17 May 2010, supported by a working paper package. The associated narrative disclosures were provided on 27 May 2010. We concluded our audit within the agreed timetable and provided our opinion to the Audit Committee on 29 June 2010 as timetabled.



Issues arising from the audit

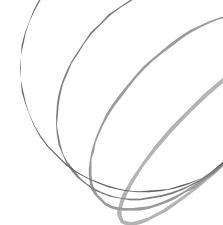
13. As required by auditing standards we reported to the Audit Committee on 29 June 2010. This was the first year the accounts were prepared under International Financial Reporting Standards (IFRS) and there were some delays in agreeing the presentation of the accounts with audit particularly in relation to non current asset accounting.

Regularity

14. 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.

International financial reporting standards (IFRS)

15. UK Government departments and other public sector bodies prepared their accounts in accordance with International Financial Reporting Standards (IFRS) for the first time in financial year 2009/10. The transition arrangements to IFRS required bodies to prepare IFRS shadow accounts for 2008/09, including revised opening balances as at 1 April 2008.
16. During 2009/10 we were required to review the shadow accounts and report on them to SEPA by 28 February 2010. The purpose of this exercise was to consider whether the shadow accounts had been properly prepared and report any matters that might prevent them forming a reliable basis for the first set of IFRS based accounts in 2009/10.
17. The shadow accounts for the 2008/09 financial year were submitted by SEPA on 14 December 2009 with full supporting documentation provided on 21 January 2010.
18. We made a recommendation for the production of the 2009/10 accounts on the proposed accounting treatment of the capital funding received from the Scottish Government for Inverdee House and the North East Flood Warning Scheme. The funding was correctly accounted for as grant in aid in the 2009/10 IFRS accounts.



Use of Resources

19. Sound management and use of resources (people, money and assets) to deliver strategic objectives is a key feature of best value. This section sets out our main findings from a review of SEPA's

- financial position
- people management.

Financial Position

Outturn 2009/10

20. SEPA is required to work within the 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 2009/10 SEPA had a deficit of £0.714 million. This is the difference between the deficit for the year of £49.060 million and the funding received from the Scottish Government of £48.346 million.

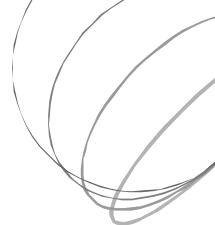
21. SEPA's balance sheet at 31 March 2010 shows net liabilities of £48.316 million (2008/09 restated net assets of £6.038 million). The movement is mainly caused by the increase in the pension liability of £56.315 million. This is an accounting estimate provided by the pension Actuary. The main financial assumptions which have driven this movement is the discount rate which has fallen from 6.9% to 5.5% and an increase in expected mortality of scheme members.

22. SEPA operated within the resource budget limits, for 2009/10 set by the Scottish Government for cash expenditure and non cash costs – see exhibit 2 below:

Exhibit 2 – Performance against resource budget 2009/10 (£ million)

Limits	Budget	Actual Outturn	Difference
Operating Expenditure - Cash	40.785	40.000	(0.785)
Operating Expenditure - Non Cash	2.151	1.451	(0.700)
Total	42.936	41.451	(1.485)

23. During 2009/10 the major capital project to build Inverdee House was completed. The total expenditure incurred at 31 March 2010 was £12.265 million funded by a combination of SEPA resources (£3.624 million), Scottish Government grant in aid (£7.891 million), and SNH contribution (£0.750 million). SEPA recorded a £5.079 million write off within the 2009/10 financial statements. This write off represented the difference between the capital expenditure incurred and the valuation provided by professional valuers to meet IFRS requirements. In addition the actuarial valuation of the pension scheme carried out in accordance with IFRS resulted in a non-cash pension adjustment of



£2.389 million. SEPA has no annual managed resource limit to cover these costs and the Scottish Government has confirmed that this would be managed at portfolio level.

24. SEPA was unable to operate within the capital expenditure budget despite transferring £0.421 million from its cash operating expenditure budget to its capital budget during the year – see exhibit 3 below:

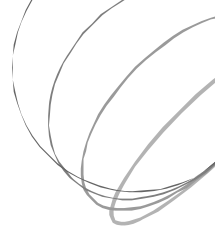
Exhibit 3 – Performance against capital budget 2009/10 (£ million)

Limits	Budget	Actual Outturn	Difference
Capital Expenditure	7.561	8.311	0.750

25. The £0.750 million overspend arose due to SEPA spending the SNH contribution to the funding for construction of Inverdee House. The annual budget allocation provided by Scottish Government was not increased to reflect this additional resource however SNH is within the same Scottish Government portfolio as SEPA and Scottish Government have confirmed that the overspend will be managed at portfolio level.

Scotland's public finances

26. The Auditor General's report on *Scotland's public finances, published in November 2009*, contained an overview of the financial environment in Scotland and the pressures and challenges facing the public sector. The aim of this report was to help to inform the debate on the future of public finances in Scotland. The key messages from this report were:



Extract from Auditor General's report *Scotland's public finances*

The public sector is coming under the greatest financial pressure since devolution.

- Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight.
- The Scottish Government and the wider public sector need to work together to develop better activity, cost and performance information. This information is needed to enable informed choices to be made between competing priorities, and to encourage greater efficiency and productivity.

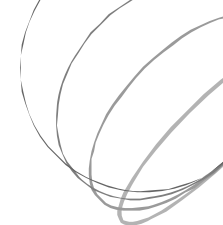
The Scottish Government faces significant challenges in balancing the budget while also delivering on its commitments and meeting increasing demands for public services.

- It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known.
- In many cases, the public sector uses income from various sources to pay for services. Income levels anticipated before the recession are unlikely to be realised, reducing the amount available to spend.
- The Scottish public sector faces significant challenges in balancing its budget while also delivering on its commitments. Changes in Scotland's population and rising unemployment rates will increase demand for public services.
- Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the smaller budget available.

In the current economic climate difficult decisions will have to be made about priority spending programmes.

- The Scottish Government's annual budget is largely developed on an incremental basis which involves making adjustments at the margin to existing budgets. This approach is not suitable for budgeting in a financial downturn because it does not easily allow informed choices to be made about priorities, based on robust information about activity, costs and performance.
- The Scottish Parliament has an important role in scrutinising the government's spending plans. Better information linking spending to costs, activities and service performance, and a rolling programme of performance reviews, would support the Scottish Parliament in fulfilling this role.

27. In April 2009 SEPA published its Annual Operating Plan 2009 - 2010 which set out the change programmes being introduced. The change programmes were driven by a number of factors including the current economic climate, changes in public sector priorities and funding, improved partnership working and the need to make regulations simpler and more effective. This has enabled SEPA to implement an organisational restructure, operational since April 2010, to encourage new ways of working and deliver further savings. This will be critical for 2010/11 given the tight financial constraints that SEPA will operate under whilst still delivering the key priorities detailed in their 2010-2011 Annual Operating Plan (Paragraphs 53 and 54).



Financial sustainability and the 2010/11 budget

28. Within the annual operating plan the budget for SEPA is £77.991 million for 2010/11. This comprises operating expenditure of £74.991 million and capital charges of £3 million.
29. This is to be funded as follows:

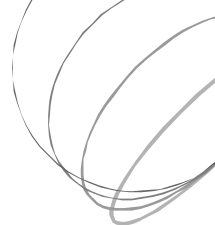
Exhibit 4 – 2010/11 Resource Plan

Limits	Budget
	£million
Grant in Aid	43.847
Charging Schemes	33.272
Other Income	0.872
Total	77.991

30. SEPA is expected to achieve 2% efficiency savings per year from 2009/10 to 2011/12 and grant in aid will not be uplifted for pay or general inflation. SEPA's 2010/11 budget, which was agreed by the Agency Board in April 2010, incorporates £3.6 million of efficiency savings which exceeds the Scottish Government target of £1.21 million. The 2010/11 budget utilises these efficiency savings to meet known cost pressures including pay inflation and pension increases. It also contains a detailed risk analysis which recognises the financial uncertainties facing SEPA and the public sector in general. SEPA must continue to manage these financial challenges, through the planned change programmes, to enable them to achieve their key performance targets.
31. SEPA has implemented a vacancy management procedure to ensure that only business critical vacancies are filled. In addition the workforce planning arrangements have included the introduction of a voluntary severance scheme and the development of a new redeployment procedure.
32. At the start of 2010 SEPA carried out a voluntary severance exercise, seeking expressions of interest from all staff. 220 staff expressed interest in the scheme, with 83 people receiving a formal voluntary severance offer. 71 individuals accepted the offer enabling SEPA to remove these posts from the staffing establishment. This voluntary severance scheme was approved and funded by the Scottish Government and cost £3.136 million resulting in annual savings of £2.581 million. In addition, 50 further frozen and unoccupied posts were deleted from the staffing establishment.

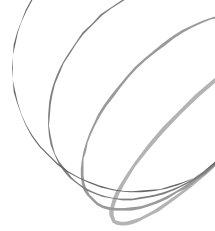
Future Studies

33. Audit Scotland has started fieldwork for the performance audit *Management of the Scottish Government's capital investment programme* which is due to be published in autumn 2010. Overall, the project aims to provide independent assurance about how well the Scottish Government is managing its capital investment programme and associated risks. It will also assess and report on the



outlook for investment spending and what improvements have been made in major project management since our previous report *Review of major capital projects in Scotland* (June 2008). The review includes Inverdee House as a case study.

34. *Improving energy efficiency: a follow-up report* will re-evaluate the performance of the public sector in improving its energy efficiency. It will assess progress made against the recommendations in the *Improving energy efficiency report 2008*. SEPA completed Audit Scotland's survey for that report. The follow up report will look at changes in public bodies' energy consumption and spending on energy since 2004/05. It will also look at how prepared participating public bodies are for the CRC Energy Efficiency Scheme. It is due to be published in December 2010.



Governance and Accountability

35. High standards of governance and accountability, with effective structures and processes to govern decision-making and balanced reporting of performance to the public, are fundamental features of best value. This section sets out our findings arising from a review of SEPA's arrangements.
36. Increasingly services are being delivered across the public sector through partnership working, sometimes involving complex governance and accountability arrangements. Best value characteristics also include effective partnership working to deliver sustained improvements in outcomes.

Overview of arrangements

37. This year we reviewed:
 - key systems of internal control
 - internal audit
 - arrangements for the prevention and detection of fraud and irregularity, including standards of conduct.
 - partnership working
38. Our overall conclusion is that arrangements within SEPA are sound and have operated throughout 2009/10.

Systems of internal control

39. 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 2009/10 KPMG, the internal auditors, provided their opinion that based on the internal audit work undertaken during the year, SEPA's systems provide a reasonable basis for maintaining control. It also states that the control framework provides reasonable assurance regarding the effective and efficient achievement of SEPA's objectives.
40. As part of our audit we reviewed the high level controls in a number of SEPA's systems that impact on the financial statements. This audit work covered a number of areas including payroll, general ledger, accounts receivable and accounts payable. Our overall conclusion was that key controls were operating effectively and that SEPA has adequate systems of internal control in place. We did identify a small number of areas where controls could be strengthened and agreed an action plan of



improvements with management. This will be followed up in 2010 to confirm that improvements have been made.

Statement on Internal Control

41. The statement on internal control provided by SEPA's 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. The statement on internal control draws attention to issues identified by internal audit in the application of internal policies and procedures for health and safety and recording employee absence data. No weaknesses were identified that would impact on the financial position of SEPA.

Internal Audit

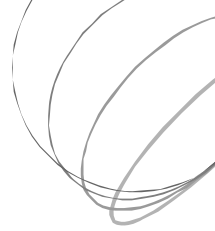
42. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2009/10 audit we assessed whether we could place reliance on SEPA's internal audit function. We concluded that KPMG operates in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in number of areas during 2009/10, as we anticipated in our annual audit plan. This included reliance on aspects of internal audit's systems work to avoid duplication of effort.

Prevention and detection of fraud and irregularities

43. 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.
44. During 2009/10 SEPA suffered two instances of fraudulent purchase card usage, £296 and £238. The cases were identified by the bank due to the unusual nature of the transactions. Both cards were cancelled and the bank refunded the payments.

Partnership working

45. In June 2007 Ministers challenged the organisations delivering the rural affairs and environment portfolio to create a single environment and rural delivery service (SEARS). SEARS brings together nine delivery-focused bodies within the Rural and Environment sector to provide more joined-up services. SEPA is one of these bodies.
46. The first annual review of SEARS was published in June 2009 and noted how far the nine organisations had come in working closely together to deliver for Scotland's land managers. This year there have been further benefits and reductions have been made on inspections resulting in more

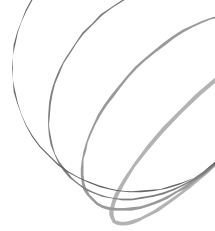


time saved for customers. Good progress also continues on bio security, co-locations and reducing bureaucracy. Preparatory work began late in 2009 to develop a pilot of the “rural hubs” concept, to further improve access to services.

47. It was under the On the Ground Initiative which preceded SEARS that SEPA started construction of the new build shared office accommodation in Aberdeen – Inverdee House. The building was completed during 2009/10 and accommodates SEPA, Scottish Natural Heritage and UK Joint Nature Conservation Committee staff. SEPA should continue to identify further opportunities within SEARS for future efficiencies through shared projects and services.

National Studies

48. In August 2010 Audit Scotland will be publishing a national study on *The Role of Boards* which will be relevant to the governance of SEPA. Boards play a crucial role in ensuring that governance standards are maintained in public sector organisations. Feedback relating to SEPA will be provided in due course where appropriate.

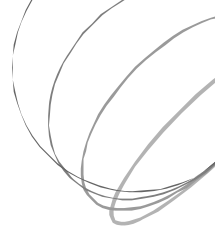


Performance

49. 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. Key features of best value include:
- setting a clear vision of what the organisation wants to achieve, backed up by plans and strategies to secure improvement, with resources aligned to support their delivery;
 - a performance management culture which is embedded throughout the organisation and a performance management framework which is comprehensive and supports the delivery of improved outcomes.
50. In this section we comment on:
- vision and strategic direction
 - performance overview
 - risk management
 - improving public sector efficiency.

Vision and strategic direction

51. 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
 - Improved water environments.
52. Within each area SEPA has set proposed key actions along with timescales for delivery. In April 2009 SEPA published the Annual Operating Plan for 2009 – 2010 to set out how the aspirations within the corporate plan would be delivered. A key aspect of the plan was an organisational change programme which provided a framework for reviewing how SEPA operates.



53. The 2010 – 2011 Annual Operating Plan has now been published building on the significant change programme already introduced. The key priorities are that by 31 March 2011 SEPA will have:
- aligned costs and funding and developed a new charging model
 - implemented significant elements of the step change in science programme
 - redesigned a number of regulation regimes to ensure affordability
 - enhanced staff development.
54. Within the 2010 – 2011 Annual Operating Plan the total number of outcomes has been reduced to reflect the need to focus on delivering key priorities. The tight financial constraints mean that the delivery of these key priorities will be challenging however SEPA is well placed given the actions already taken.

Performance overview

55. For 2009/10 SEPA has met 18 of its 20 key targets, including exceeding the Scottish Government's efficiency target and delivering corporate objectives within budget. The 2 remaining targets were revised to reflect SEPA's current operating regime. The target to prioritise service reviews with the aim of reducing costs by 10% was superseded by the change programme. The other target of ensuring 92% permit compliance for Pollution Prevention and Control Installations, was superseded by SEPA concentrating on ensuring compliance with the new scheme which was introduced in January 2009. The new scheme was designed to assess compliance across regimes and ensure a consistent approach. After the first phase of implementation, SEPA sought feedback from industry regulated under Pollution Prevention and Control and this has helped identify areas for further improvement. This represents a good performance in a year where SEPA had undertaken a fundamental review of its operations and introduced a voluntary severance scheme.

Risk management

56. SEPA has sound risk management arrangements in place including the establishment and maintenance of a corporate risk register with quarterly reporting to the Corporate Management Team and annual reporting to the Audit Committee and Board.
57. Some of the main risk areas are:
- **Risk from current economic environment** – As has been noted elsewhere in this report, one of the significant challenges SEPA face relates to its ability to operate in the current economic climate. The key actions identified to mitigate this risk include continued identification and realisation of efficiency savings and management of the change programmes.



- **Security and data handling** – SEPA’s systems and management processes do not meet the UK Government’s requirements for holding classified materials. SEPA is allowed to continue to hold classified materials on systems, providing there is continued progress to achieve required standards. SEPA has developed a secure IT environment within which this type of data can now be stored and are continuing to implement security measures.
- **Management of absence** – Sickness absence can represent a significant cost to an organisation. SEPA identified that there was a lack of robust sickness absence information and reporting. Arrangements have recently been strengthened.

58. We will continue to monitor SEPA’s risk management arrangements and the progress made in each of these areas over the course of the year.

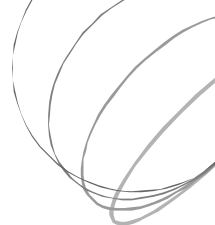
Improving public sector efficiency

59. The Audit Scotland report *Improving public sector efficiency* was published on 25 February 2010. It provides a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in the 2006 report about the previous efficiency programme.

60. The report found that Scottish public bodies reported more efficiency savings than the Government’s two per cent target, however there are serious financial challenges ahead and making the required savings through efficiency will become increasingly difficult.

61. The report recommended that to deal with reduced future funding and increase savings public bodies need to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and improving collaboration and joint working.

62. The drive to improve efficiency and productivity is not just an exercise for managers and service providers. It requires strong leadership and engagement and senior decision-makers within an organisation have a responsibility to check, challenge, monitor and support their organisations in delivering efficiency and productivity improvements. The report’s recommendations highlighted areas that public bodies’ key decision makers should look at to assess their organisation’s development and to challenge existing arrangements (see below).

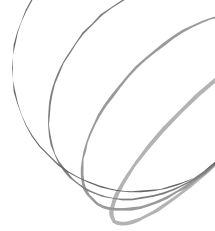


Extract from Audit Scotland report *Improving public sector efficiency*

In order to improve the delivery of efficiency savings public bodies should:

- ensure they have a priority-based approach to budgeting and spending
- continue to improve collaboration and joint working, overcoming traditional service boundaries
- consider using alternative providers of services, if these providers can improve the efficiency, productivity or quality of services
- improve information on costs, activity, productivity and outcomes, including setting baselines to measure performance against
- give greater urgency to developing benchmarking programmes
- maintain the momentum of activities and initiatives to improve purchasing and asset management and extend shared services
- ensure there is a joined-up approach to efficiency savings across the public sector, avoiding duplication
- ensure that plans are in place to deliver savings, clearly setting out what action will be taken, the level of savings to be delivered and how these will be measured
- strengthen the involvement of front-line staff, service providers and users in redesigning public services
- reduce reliance on non-recurring savings to meet financial targets and generally use these as part of a wider and longer term strategy
- report efficiency savings consistently.

63. To support these high-level recommendations, Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office developed a detailed good practice checklist. The checklist is intended to promote detailed review, reflection and, if necessary, a basis for improvement. SEPA has recently completed an assessment of its position against the good practice checklist. The results were reported to the Audit Committee in June 2010 and will continue to be kept under review.
64. SEPA is expected to achieve 2% efficiency savings per year from 2009/10 to 2011/12 and grant in aid will not be uplifted for pay or general inflation. SEPA had a cumulative cash efficiency target of £1.45 million set by the Scottish Government for the two years to 31 March 2010. SEPA achieved savings of £4.97 million over the period. SEPA's 2010/11 budget incorporates £3.6 million of efficiency savings which exceeds the Scottish Government target of £1.21 million. The £3.6 million savings have arisen from the removal of posts frozen in 2009/10 (£1.3 million) and the removal of posts identified under the voluntary severance scheme (£2.3 million).
65. SEPA has identified the key risks to achieving financial balance, including:
- non pay price inflation, particularly utilities, may not be containable within budgets
 - income may fall below anticipated levels due to further, unforeseen impacts of the economic downturn including charging scheme impacts and actions taken by the Water Authority to improve their discharges
 - further asset impairments due to economic conditions
66. We will continue to monitor the financial position of SEPA and the actions taken to manage these risks.



Looking Forward

67. SEPA faces a number of challenges in 2010/11 including:

- **Efficiencies and future funding** – The announcement of future budget cuts by the new UK government indicates that there will be serious financial challenges ahead. SEPA has already implemented an organisational restructure and identified significant efficiencies, however it is vital that work continues to ensure that SEPA can continue to deliver services within the tight financial constraints. SEPA should also continue to identify further opportunities within SEARS for future efficiencies through shared projects and services.
- **Financial management and affordability** - SEPA's 2010/11 budget incorporates £3.6 million of efficiency savings from the removal of posts frozen in 2009/10 (£1.3 million) and the removal of posts identified under the voluntary severance scheme (£2.3 million). SEPA recognises that there are a number of risks to financial stability and these risks must continue to be managed. We will consider SEPA's financial management arrangements as part of the 2010/11 audit.
- **Best Value** - The concept of best value is seen as a key driver of modernisation and improvement in public services. Audit Scotland has continued its commitment to extending the best value audit regime across the whole public sector and significant development work has taken place over the last year including the finalisation of its best value toolkits. This has been matched by the Scottish Government's commitment to refreshing its Best Value Guidance for Public Bodies. SEPA should continue to respond to this important initiative as it develops.