

# Report to those charged with governance on the 2013/14 audit

Audited Body:	Scottish Natural Heritage
Committee:	Audit and Risk Management Committee
Date:	24 July 2014

## Background

1. International Standard on Auditing (UK and Ireland) 260 (ISA 260) requires auditors to report specific matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action.
2. This report is for the Audit and Risk Management Committee (ARMC) for consideration of the matters arising from the audit of the financial statements for 2013/14 that require to be reported under ISA 260. We are drawing to your attention those matters we think are worthy of note and consideration before the financial statements are approved and certified. It should be noted that the audit opinion reflects recent discussions with management and is subject to the satisfactory conclusion of any outstanding matters (if applicable).
3. We also present for your consideration our Annual Audit Report on the 2013/14 audit which identifies any significant findings from the financial statements audit. The Annual Audit Report is attached at [Appendix C](#).

## Status of the work

4. We have completed the audit of Scottish Natural Heritage's accounts. The issues arising from the financial statements audit were included in a matters arising schedule issued to the Head of Finance and Financial Accountant on 1 July 2014 and discussed during the final accounts clearance meeting on 4 July 2014.

## Fraud

5. In presenting this report to the ARMC we seek confirmation from those charged with governance of any instances of fraud that have arisen which should be brought to our attention. A specific confirmation from management in relation to fraud has been included in the draft letter of representation attached at [Appendix B](#).

## Audit opinion and representations

6. Subject to the satisfactory conclusion of any outstanding matters and receipt of a revised set of financial statements for final review, we anticipate being able to issue an unqualified

auditor's report on 24 July 2014 (the proposed report is attached at [Appendix A](#)). There are no anticipated modifications to the audit report.

7. We are required to report to those charged with governance all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature which we regard as errors less than £1,000.
8. A number of presentational adjustments were identified by SNH finance officer and Audit Scotland within the draft financial statements during the course of our audit. These have been reflected in the revised financial statements. These were discussed with senior finance officers who agreed to amend the unaudited financial statements. The overall effect of the adjustments made to the financial statements is a decrease in total comprehensive net expenditure by £10,000. A summary of the main adjustments are contained in the Annual Audit Report ([Appendix C](#), paragraph [10](#)).
9. We therefore have no unadjusted misstatements to bring to your attention.
10. As part of the completion of our audit we seek written assurances from the Accountable Officer on aspects of the financial statements and judgements and estimates made. A draft letter of representation under ISA580 is attached at [Appendix B](#). This should be signed and returned by the Accountable Officer with the signed financial statements prior to the independent auditor's opinion being certified.

### Significant findings and key judgements

11. In our view, there are no issues which require to be brought to your attention regarding the appropriateness of accounting policies or accounting estimates and judgements, the timing of transactions, the existence of material unusual transactions or the potential effect on the financial statements of any uncertainties.

### Outstanding matters

12. There are no outstanding matters.

# Appendix A: Proposed Independent Auditor's Report

## **Independent auditor's report to Scottish Natural Heritage, the Auditor General for Scotland and the Scottish Parliament**

I have audited the financial statements of Scottish Natural Heritage for the year ended 31 March 2014 under the Natural Heritage (Scotland) Act 1991. The financial statements comprise the Statement of Comprehensive Net Expenditure, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Taxpayers' Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the 2013/14 Government Financial Reporting Manual (the 2013/14 FReM).

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Auditor General for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

### **Respective responsibilities of Accountable Officer and auditor**

As explained more fully in the Statement of Board and Accountable Officer's Responsibilities, the Accountable Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and is also responsible for ensuring the regularity of expenditure and income. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors. I am also responsible for giving an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the body's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by

the Accountable Officer; and the overall presentation of the financial statements. It also involves obtaining evidence about the regularity of expenditure and income. In addition, I read all the financial and non-financial information in the Annual Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements, irregularities, or inconsistencies I consider the implications for my report.

### **Opinion on financial statements**

In my opinion the financial statements:

- give a true and fair view in accordance with the Natural Heritage (Scotland) Act 1991 and directions made thereunder by the Scottish Ministers of the state of the body's affairs as at 31 March 2014 and of its net expenditure for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2013/14 FReM; and
- have been prepared in accordance with the requirements of the Natural Heritage (Scotland) Act 1991, Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers.

### **Opinion on regularity**

In my opinion in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

### **Opinion on other prescribed matters**

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with the Natural Heritage (Scotland) Act 1991 and directions made thereunder by the Scottish Ministers; and
- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

### **Matters on which I am required to report by exception**

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Governance Statement does not comply with guidance from the Scottish Ministers.

I have nothing to report in respect of these matters.

Brian Howarth, ACMA CGMA  
Audit Scotland  
4th Floor, South Suite  
8 Nelson Mandela Place  
Glasgow  
G2 1BT

24 July 2014

# Appendix B: ISA 580 - Letter of Representation

Brian Howarth, ACMA CGMA  
Assistant Director  
Audit Scotland  
4th Floor, South Suite  
8 Nelson Mandela Place  
Glasgow  
G2 1BT

Dear Brian

**RE: Scottish Natural Heritage  
Annual Accounts 2013/14**

1. This representation letter is provided in connection with your audit of the financial statements of Scottish Natural Heritage for the year ended 31 March 2014 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of Scottish Natural Heritage, as at 31 March 2014 and its comprehensive net expenditure and application of funding for the year then ended.
2. I confirm to the best of my knowledge and belief, and having made appropriate enquiries of the Management Team and the Board, the following representations given to you in connection with your audit of Scottish Natural Heritage for the year ended 31 March 2014.

## **General**

3. I acknowledge my responsibility and that of Scottish Natural Heritage for the financial statements. All the accounting records requested have been made available to you for the purposes of your audit. All material agreements and transactions undertaken by Scottish Natural Heritage have been properly reflected in the financial statements. All other records and information have been made available to you, including minutes of all management and other meetings.
4. The information given in the Annual Report to the financial statements, including the Strategic Report and the Board and Management Team Report and Remuneration Report, presents a balanced picture of Scottish Natural Heritage and is consistent with the financial statements.
5. I confirm that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. I am not aware of any uncorrected misstatements other than those identified in the auditor's report to those charged with governance (ISA 260).

### **Regularity of Financial Transactions**

6. The financial transactions of Scottish Natural Heritage are in accordance with the relevant legislation and regulations governing its activities and expenditure and income were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers.

### **Financial Reporting Framework**

7. The financial statements have been prepared in accordance with the Natural Heritage (Scotland) Act 1991, 2013/14 Government Financial Reporting Manual and in accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers including all relevant presentation and disclosure requirements.
8. Disclosure has been made in the financial statements of all matters necessary for them to show a true and fair view of the transactions and state of affairs of Scottish Natural Heritage for the year ended 31 March 2014.

### **Accounting Policies & Estimates**

9. All material accounting policies adopted are as shown in the Statement of Accounting Policies included in the financial statements. The continuing appropriateness of these policies has been reviewed since the introduction of IAS 8 and on a regular basis thereafter, and takes account of the requirements set out in the 2013/14 Government Financial Reporting Manual.
10. The significant assumptions used in making accounting estimates are reasonable and properly reflected in the financial statements. There are no changes in estimation techniques which should be disclosed due to their having a material impact on the accounting disclosures.

### **Going Concern**

11. The Board and Directors have assessed Scottish Natural Heritage's ability to carry on as a going concern, as identified in the Statement of Accounting Policies, and have disclosed, in the financial statements, any material uncertainties that have arisen as a result.

### **Related Party Transactions**

12. All transactions with related parties have been disclosed in the financial statements. I have made available to you all the relevant information concerning such transactions, and I am not aware of any other matters that require disclosure in order to comply with the requirements of IAS24, as interpreted by the 2013/14 Government Financial Reporting Manual.

### **Events Subsequent to the Date of the Statement of Financial Position**

13. There have been no material events since the date of the Statement of Financial Position which necessitate revision of the figures in the financial statements or notes thereto including contingent assets and liabilities.
14. Since the date of the Statement of Financial Position no events or transactions have occurred which, though properly excluded from the financial statements, are of such importance that they should be brought to your notice.

### **Corporate Governance**

15. I acknowledge as Accountable Officer my responsibility for the corporate governance arrangements. I confirm that I have disclosed to the auditor all deficiencies in internal control of which I am aware.
16. The corporate governance arrangements have been reviewed and the disclosures I have made are in accordance with the 2013/14 Government Financial Reporting Manual. There have been no changes in the corporate governance arrangements or issues identified, since the 31 March 2014 which require disclosure.

### **Fraud**

17. I have considered the risk that the financial statements may be materially misstated as a result of fraud. I have disclosed to the auditor any allegations of fraud or suspected fraud affecting the financial statements. There have been no irregularities involving management or employees who have a significant role in internal control or that could have a material effect on the financial statements.

### **Assets**

18. The assets shown in the Statement of Financial Position at 31 March 2014 were owned by Scottish Natural Heritage, other than assets which have been purchased under operating leases. Assets are free from any lien, encumbrance or charge except as disclosed in the financial statements.

### **Liabilities**

19. All liabilities have been provided for in the books of account, including the liabilities for all purchases to which title has passed prior to 31 March 2014.

### **Carrying Value of Assets and Liabilities**

20. The assets and liabilities have been recognised, measured, presented and disclosed in accordance with 2013/14 Government Financial Reporting. There are no plans or intentions that are likely to affect the carrying value of classification of the assets and liabilities within the financial statements.



## Provisions

21. Provisions have been made in the financial statements for all material liabilities which have resulted or may be expected to result, by legal action or otherwise, from events which had occurred by 31 March 2014 and of which Scottish Natural Heritage could reasonably be expected to be aware of. The amount recognised as a provision is the best estimate of the expenditure likely to be required to settle the present obligation at 31 March 2014.

Yours sincerely

Ian Jardine

Accountable Officer  
Date

# Appendix C

## Scottish Natural Heritage

### Annual Audit Report on the 2013/14 Audit

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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# Key Messages

We have given an unqualified opinion on the financial statements of Scottish Natural Heritage (SNH) for 2013/14.

SNH operated within the total resource budget agreed with the Scottish Government, but required £1m additional cash funding from the Scottish Government in 2013/14 (over and above its resource allocation) in order to ensure that payments could be made as they fell due (effectively year-end cash flexibility). This additional funding has no impact on next year's resource allocation.

SNH significantly over-committed programme/project funding in the first half of 2013/14, as part of an approach to mitigate the potential effect on outturn of Quarter 4 slippage on projects. The extent of over commitment exceeded the amount in prior years. This was recognised and corrected during November 2013 to January 2014. As a result, internal audit carried out a review of SNH's budgetary control processes leading to recommendations to improve the budgeting process going forward.

# Introduction

1. This report is the summary of our findings arising from the 2013/14 audit of Scottish Natural Heritage (SNH). The purpose of the report is to set out concisely the scope, nature and extent of the audit. It summarises our opinions on the financial statements and conclusions on significant issues arising.
2. The report also reflects our overall responsibility to carry out an audit in accordance with the public sector audit model which is based on the Code of Audit Practice prepared by Audit Scotland (May 2011). This sets out the wider dimensions of the public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements prepared by management; however this does not relieve management of their responsibilities in this respect. This report has been prepared for the use of SNH and no responsibility to any third party is accepted.
3. A number of reports have been issued in the course of the year in which we make recommendations for improvements. These are summarised in Table 1 below and have been reported to the Audit and Risk Management Committee (ARMC). We do not repeat all of the findings in this report and instead, focus on the financial statements and any issues arising as a result.
4. We have not identified any high level risks from the 2013/14 audit.

**Table 1: External audit reports and audit opinions issued for 2013/14**

Title of report or opinion	Target Delivery Date	Date presented to ARMC
Annual Audit Plan	18 February 2014	27 February 2014
Internal Controls Report	10 April 2014	29 May 2014
Your Business @ Risk Survey Results (YB@R)	Additional output, not in original plan	29 May 2014
Combined Annual Audit Report and ISA260 Report	17 July 2014	24 July 2014

5. This Annual Audit Report is also addressed to the Auditor General for Scotland and will be published on our website ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)) after consideration by the ARMC and after the Annual Report and Accounts have been laid before parliament.

# Financial statements

## Conduct and scope of the audit

6. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in the Annual Audit Plan presented to the ARMC on 27 February 2014, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.
7. As part of the requirement to provide full and fair disclosure of matters relating to our independence we can confirm that we have not undertaken non-audit related services. The 2013/14 agreed fee for the audit was disclosed in the Annual Audit Plan and as we did not require carrying out any additional work outwith our planned audit activity this fee remains unchanged.

## Audit opinion & accounting issues

8. We have given an unqualified opinion that the financial statements of SNH for 2013/14 give a true and fair view of the state of the body's affairs and of its net expenditure for the year. The financial statements were signed by the Chief Executive, as accountable officer, on 24 July 2014.
9. We received the unaudited financial statements on 30 May 2014 in accordance with the agreed timetable. The working papers were of a high standard and the staff provided good support to the audit team throughout the year. We completed our fieldwork on 20 June 2014 and matters arising were discussed on a regular basis with SNH's Head of Finance and Financial Accountant. We recommended a number of minor changes to the presentation of the financial statements, and these have been processed by management.
10. The main financial changes to the draft accounts during the audit are detailed below:
  - A reclassification of assets between land and buildings, totalling £30,000
  - A minor adjustment was made to a capital retention accrual (£8,000)
  - A reclassification of expenditure to more appropriate account codes within the ledger which resulted in a £20,000 decrease in other costs and a matching increase in operating costs.
11. SNH is required to follow the 2013/14 Financial Reporting Manual (the FReM) and we can confirm that the financial statements have been properly prepared in accordance with these accounting requirements and the accounts direction from Scottish Ministers.

## Significant findings and key judgements (ISA 260)

12. There were no significant issues that we are required to communicate in accordance with ISA 260.

## Financial position

### 2013/14 Outturn

13. The main financial objective for SNH is to ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers.
14. SNH received a total final resource budget of £54.078 million for 2013/14. Overall, SNH operated within the total final resource budget.

**Table 2: 2013/14 Resource Budget**

	Initial Budget (£'000)	Final Budget (£'000)	Actual Outturn (£'000)	Under / (Over) spend (£000)
Resource DEL	51,054	49,798	49,504	294
Ring Fenced (non-cash)	3,080	3,080	2,551	529
Capital DEL	1,200	1,200	1,223	(23)
<b>Total</b>	<b>55,334</b>	<b>54,078</b>	<b>53,278</b>	<b>800</b>
AME	0	0	(49)	49

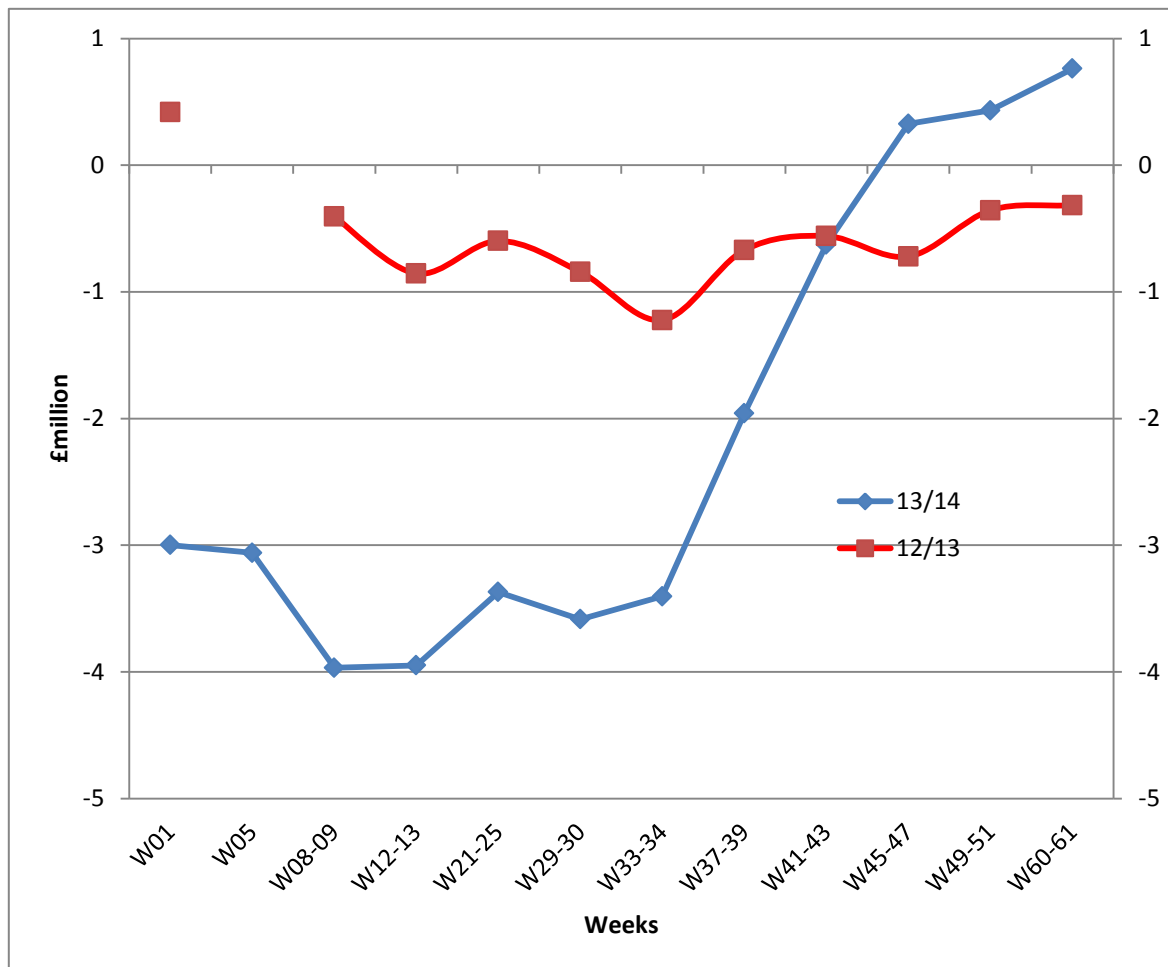
Source: 2013/14 Scottish Government Budget Allocation letters

15. In December 2013, SNH informed its Sponsor Branch in the Scottish Government that they were forecasting an overspend for 2013/14. In the final budget revision letter from April 2014 the Scottish Government notified additional cash funding of £1 million to ensure that SNH could meet its liabilities, in cash, as they fell due. We have confirmed with the Scottish Government auditors that this has no effect on the SNH funding position in 2014/15.
16. As we note at paragraph 29 (page 19), SNH identified weaknesses in its budgetary control processes during the year. SNH engaged Internal Audit to review their approach to budgeting and recommendations in the internal audit report are already being implemented by SNH to help mitigate against any budget shortfalls going forward.
17. The core of the issues experienced by SNH was the extent to which budgets are over-committed to take account of project slippage that develops during the year. In the first part of 2013/14 projects were more significantly over-committed than had been the case in previous



years. The graph below demonstrates the extent of over-allocation on project budgets in 2013/14 compared to 2012/13. The negative figures illustrate the extent to which operational budgets were allowed to exceed their annual budget as the year developed. In 2012/13 this tended not to exceed £1 million however in 2013/14 this was increased to between £3 and £4 million until corrective action was taken in November 2013 to January 2014.

**Figure 1: SNH Budget Over-Allocation 2013/14 and 2012/13**



Source: SNH Weekly Numbers Reports (2012/13; 2013/14)

18. The budget reports at the start of 2013/14 noted that, "in order to mitigate the potential effect of Q4 slippage, the Programme Managers approved a high level of over-allocation on the operating budget..." This action, with hindsight, may well have been a reaction to the financial position at the end of 2012/13, when budget was surrendered to the Scottish Government (£750,000 at Spring Budget Revision).
19. Spending was within the final budget set, mainly as a result of programme/project deferrals and budget adjustments. For example, SNH curtailed some building maintenance projects (with spend in this area falling by £0.558 million from £0.816 million the previous year).

## 2013/14 Financial position

20. Based on the review and improvements made to budgetary control processes, the immediate financial position of SNH remains stable with SNH demonstrating that it can adjust its activity to deliver within its budget allocation. There are however further financial pressures over the next few years due to the continued expected downwards pressure on grant in aid settlements.

## Outlook

### 2014/15 budget

21. SNH has received budget approval from the Scottish Ministers of £53.094m<sup>1</sup> for 2014/15 (2014/15 draft budget prior to any autumn/spring budget revisions). The £2.2 million reduction in budget from 2013/14 is part of the on-going policy of efficiency savings that SNH has been asked to make in previous years<sup>2</sup>.
22. SNH is also undergoing a change agenda in line with the current corporate plan. A significant part of this involves a reduction in staff costs of 20% from 2010/11 levels by 2015. The business performance report for quarter 4 of 2013/14 reported a £0.827m paybill overspend and forecast that staff costs will be reduced to intended levels in 2015/16, slightly later than planned.
23. A paper presented to the ARMC in May 2014 set a timescale for the production of a workforce plan by April 2015. Such a plan should ensure that SNH achieves its target paybill whilst ensuring that the body can continue to deliver to its stated remit, i.e. it will ensure that the correct level of skills and experience are retained/developed.

## Corporate governance and systems of internal control

### Overall governance arrangements

24. The three fundamental principles of corporate governance - openness, integrity and accountability- apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
25. The Code of Audit Practice gives auditors a responsibility to review and report on audited bodies' corporate governance arrangements and overall we found that SNH had sound governance arrangements in place, with the Board and ARMC overseeing key aspects of governance.

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<sup>1</sup> [Rural Affairs & Environment SPICE Draft Budget 2014/15](#) (level 4 summary)

<sup>2</sup> Per [Committee Report on Draft Budget 2014/15](#)

## Accounting and internal control systems

26. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.
27. With the exception of the issues found with the budgetary control system, no material weaknesses were identified elsewhere in the accounting and internal control systems during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.
28. Internal audit is an important element SNH's governance structure. As part of our risk assessment and planning process we assessed the Internal Audit function of both the in-house team and that of Scott-Moncrieff and concluded that they operate in accordance with Public Sector Internal Audit Standards (PSIAS).
29. In SNH's Annual Internal Audit Report to the Accountable Officer for 2013/14, the head of internal audit provided the opinion that;

*"Given the scope and current status of the 2013-2014 audit plan, including work carried over, I am able to provide an assurance to the Accountable Officer that SNH's systems relating to risk management and corporate governance are broadly sound."*

*"However, there are internal control weaknesses in the area of budget management that have led to weak assurances being provided in two closely connected key audits (SNH's Budgeting Approach and Paybill Modelling). These weaknesses could potentially materially impact on the achievement of some of SNH's business priorities and/or SNH's reputation. In line with SG Public Finance Manual Guidance, these weaknesses should be considered for inclusion in the Governance Statement for the period 2013-14."*

## Prevention and detection of fraud and irregularity

30. In our Annual Audit Plan we highlighted the responsibility audited bodies have for establishing arrangements to prevent and detect fraud and other irregularities. In our opinion, SNH's overall arrangements for the prevention of fraud are satisfactory, although it should be noted that no system can eliminate the risk of fraud entirely. SNH participate in the National Fraud Initiative and the next exercise is due to take place in 2014/15.

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

31. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial

instructions. Auditors consider whether bodies have adequate arrangements in place. Subject to our comments below, on information security, no issues have been identified.

### **Your Business at Risk (YB@R)**

32. YB@R is a web-based survey designed to help bodies quickly assess procedural, cultural and ethical compliance risks that have the potential to undermine the effectiveness of their information governance policies. This is the fourth occasion that SNH has undertaken this survey since 2009 and the outcomes in comparison to the benchmark data provide a positive story regarding the level of awareness across the organisation. However there are a number of areas, such as procedures covering loss of equipment, where SNH needs to continue to develop and reinforce understanding in order to improve overall staff awareness of information security.

### **Acknowledgements**

33. We would like to express our thanks to the staff of SNH for their help and assistance during the audit of this year's financial statements which has enabled us to provide an audit report within the agreed timetable.