



# Scottish Natural Heritage

Annual audit report  
2014/15

July 2015

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This report has been prepared for the use of Scottish Natural Heritage and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the audit committee. The information in this report may be used by Audit Scotland in any reporting to the Scottish Parliament.

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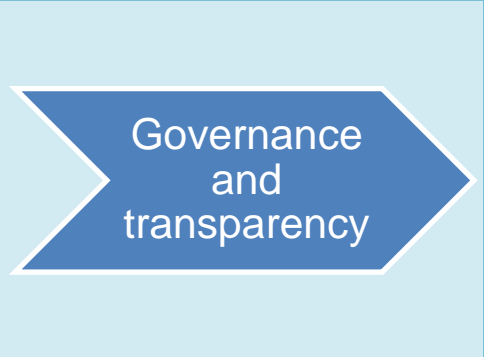
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# Key Messages

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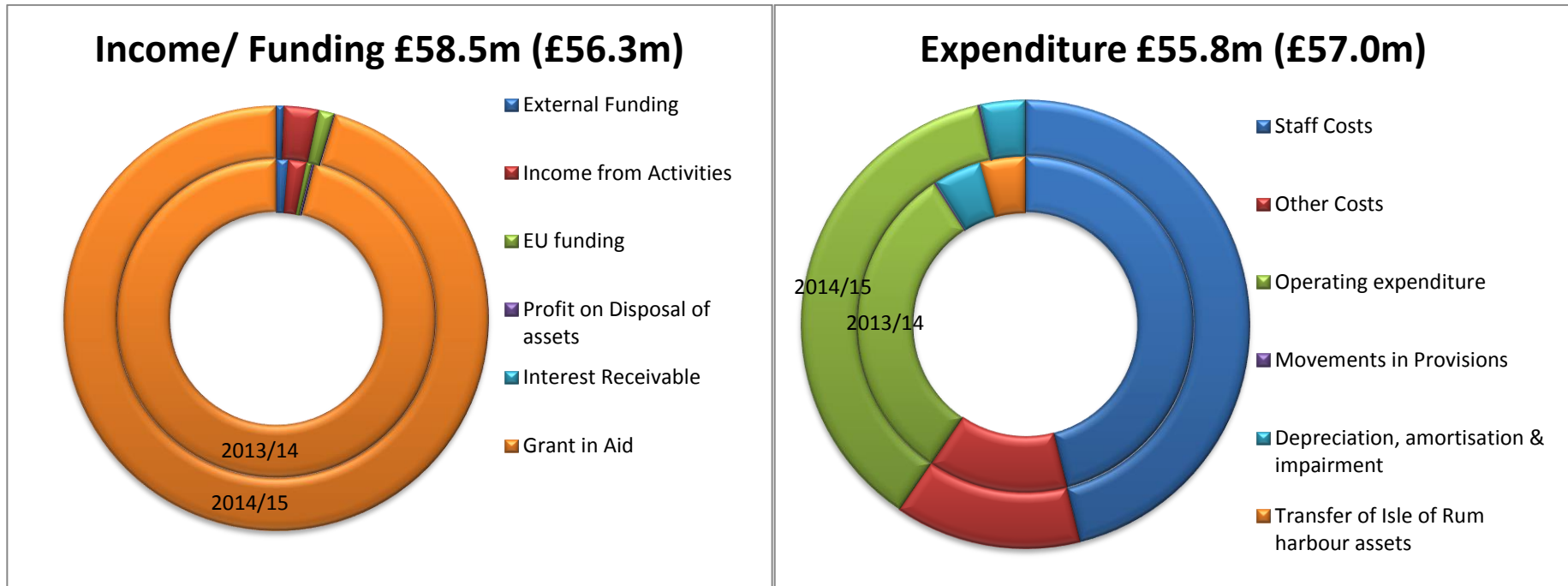
 <p>Audit of financial statements</p>	<ul style="list-style-type: none"><li>• Unqualified independent auditor's report on the 2014/15 financial statements.</li></ul>
 <p>Financial management and sustainability</p>	<ul style="list-style-type: none"><li>• Scottish Natural Heritage operated within its resource budget for 2014/15.</li><li>• The financial position remains stable. A balanced budget of income and expenditure is projected for a 3 year period to 2017 based on continuing Grant in Aid provision.</li></ul>
 <p>Governance and transparency</p>	<ul style="list-style-type: none"><li>• Overall we found that Scottish Natural Heritage had sound governance arrangements in place during 2014/15.</li><li>• Systems of internal control operated effectively during 2014/15 with no issues to report.</li></ul>

# Introduction

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1. This report is a summary of our findings arising from the 2014/15 audit of Scottish Natural Heritage (SNH).
2. The management of SNH is responsible for:
  - preparing financial statements which give a true and fair view, in accordance with the relevant financial reporting framework
  - ensuring the regularity of transactions, by putting in place systems of internal control
  - maintaining proper accounting records
  - preparing and publishing with their financial statements an annual governance statement and a remuneration report
  - preparing a Whole of Government Accounts return (not subject to audit).
3. Our responsibility, as the external auditor of SNH, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of 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; that have been prepared by management with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.
5. We have not identified any high level risks from the audit that would result in a recommendation for management. We recognise that not all risks can be eliminated or even minimised. What is important is that SNH understands its risks and has arrangements in place to manage these risks.
6. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
7. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These have been reviewed by SNH and shared with staff and the Audit and Risk Management Committee. These reports are summarised at [appendix II](#) and [appendix III](#).
8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

# 2014/15 financial statements



The financial statements show income and funding of £58.5 million this year, £2.2 million (4%) more than last year. This was mainly due to additional in year funding for peatland restoration.

Expenditure has reduced by £1.2 million as the one-off costs relating to the transfer of Isle of Rum harbour assets which affected 2013/14 no longer apply. This is off-set by an increase in other expenditure headings in 2014/15, most notably operating costs which has seen a rise of £2.8 million (16%) largely due to peatland restoration expenditure.

# Audit of the 2014/15 financial statements

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## Audit opinions

### Financial Statements

- The financial statements of SNH for 2014/15 give a true and fair view of the state of the body's affairs and of its net expenditure for the year.
- We confirm that the financial statements have been properly prepared in accordance with the 2014/15 FReM and the requirements of the Natural Heritage (Scotland) Act 1991 and directions.

### Regularity

- In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

### Other prescribed matters

- The remuneration report has been properly prepared in accordance with the requirements of the Natural Heritage (Scotland) Act 1991 and directions.
- The information in the management commentary (comprising the strategic report and management team) report is consistent with the financial statements.

## Audit of the 2014/15 financial statements

### Submission of financial statements for audit

9. We received the unaudited financial statements on 29 May 2015 in accordance with the agreed timetable. The working papers were of a high standard and the staff provided good support to the audit team and we completed our on-site fieldwork on 17 June 2015.

### Overview of the scope of the audit of the financial statements

10. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the ARMC on 26 February 2015.
11. 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 2014/15 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged (£52,520).
12. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified several audit risks which had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

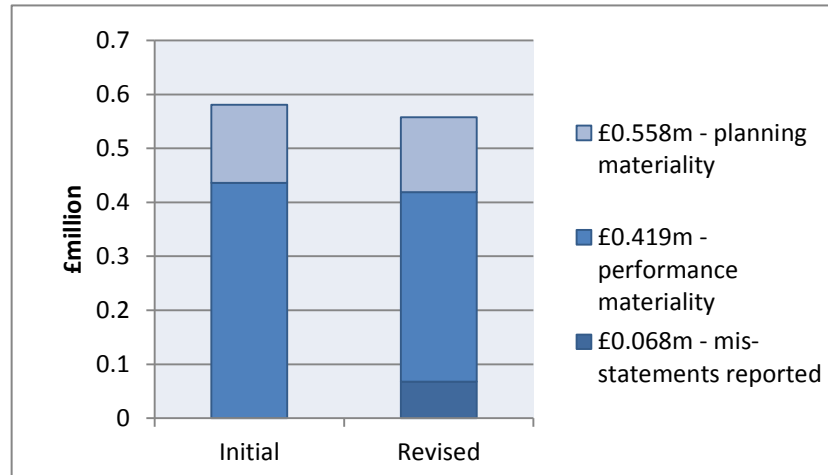
13. [Appendix I](#) sets out the significant audit risks identified and how we addressed each risk in arriving at our opinion on the financial statements.
14. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

### Materiality

15. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other qualitative reasons (for example an item contrary to law).
16. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
17. We summarised our approach to materiality in our Annual Audit Plan. Based on the financial statements, we reviewed our materiality levels for 2014/15 to £558,000 (1% of gross expenditure). Performance materiality of £419,000 has been

## Audit of the 2014/15 financial statements

determined to ensure that uncorrected and undetected audit differences do not exceed our planning materiality. We report all misstatements greater than £20,000.



### Evaluation of misstatements

18. There were no misstatements identified during the audit, which have not been adjusted in the financial statements.
19. During the audit process finance officers within SNH identified three adjustments which were amended. These adjustments resulted in a decrease to net expenditure of £68,000 and an increase in net assets of the same amount.

### Significant findings from the audit

20. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit:

- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and disclosures.
  - Significant difficulties encountered during the audit.
  - Significant matters arising from the audit that were discussed, or subject to correspondence with management.
  - Written representations requested by the auditor.
  - Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.
21. During the course of the audit we identified that there are no matters, that we wish to draw your attention in accordance with ISA260. There were a number of presentation issues which were discussed and agreed with officers and subsequently amended.

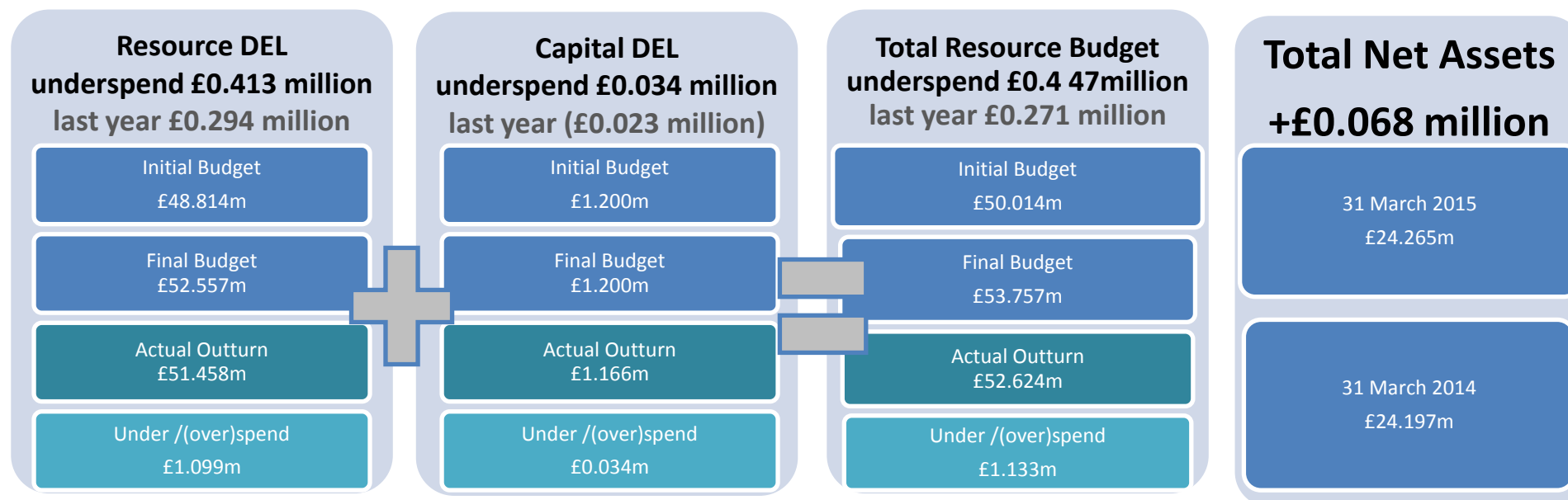


### Future accounting and auditing developments

#### Revisions to the Financial Reporting Manual

22. The financial statements are prepared in accordance with the Government financial reporting manual (FReM). Three significant revisions will apply from 2015/16:
- Adoption of IFRS13 *Fair Value Measurement* for the first time – this also includes IAS 16 and IAS 38 adaptations.
  - Adoption of IAS 36 Impairment of assets - to be applied when IFRS 13 is introduced in the FReM.
  - Simplification and Streamlining Project – changes to the form and content of the annual report and accounts.
23. **International Financial Reporting Standards (IFRS) 13 Fair Value Measurement:** Sets out the requirements for assets to be valued at fair value and is applied in full by the FReM only to assets that are not held for their service potential (i.e. investment properties and assets held for sale). It also applies to operational assets which are surplus to requirements where there are no restrictions on disposal which would prevent access to the market.
24. IFRS 13 does not apply to operational assets which are in use delivering front line services or back office functions, and surplus assets with restrictions on their disposal. These will be valued in accordance with the adaptations to *IAS (International Accounting Standard) 16 Property, Plant and Equipment*.
25. International Accounting Standard (IAS) 36 Impairment of assets: this amendment seeks to address the implications of references to IFRS 13 'Fair Value Measurement', and modifies some of the disclosure requirements regarding measurement of the recoverable amount of impaired assets.
26. **Restructuring of the annual audit report:** The 2015/16 FReM has been extensively re-written to require the annual report and accounts to include:
- a performance report which will give a fair, balanced and understandable analysis of performance and will include an overview section and a performance analysis section.
  - An accountability report incorporating the following three main sections:
    - corporate governance report consisting of a directors' report, a statement of the Accountable Officer's responsibilities and a governance statement
    - remuneration and staff report which will cover a number of prescribed disclosures including remuneration policy, payments to directors, staff numbers and sickness absence rates
    - parliamentary and accountability report which will include information on the regularity of expenditure and the independent auditor's report.

# Financial management and sustainability



To allow funds to be redeployed to other areas of priority work within the Scottish Government, it was agreed that SNH would draw down as cash grant in aid, all but £0.686 million of the Resource DEL budget allocation for 2014/15. After taking account of this, the underspend reported above of £1.133 million is reduced to £0.447 million.

In addition to its resource budget above, SNH also had a non-cash DEL budget and a (negative) AME budget, both of which were underspent (by £0.372 million and £0.040 million respectively).

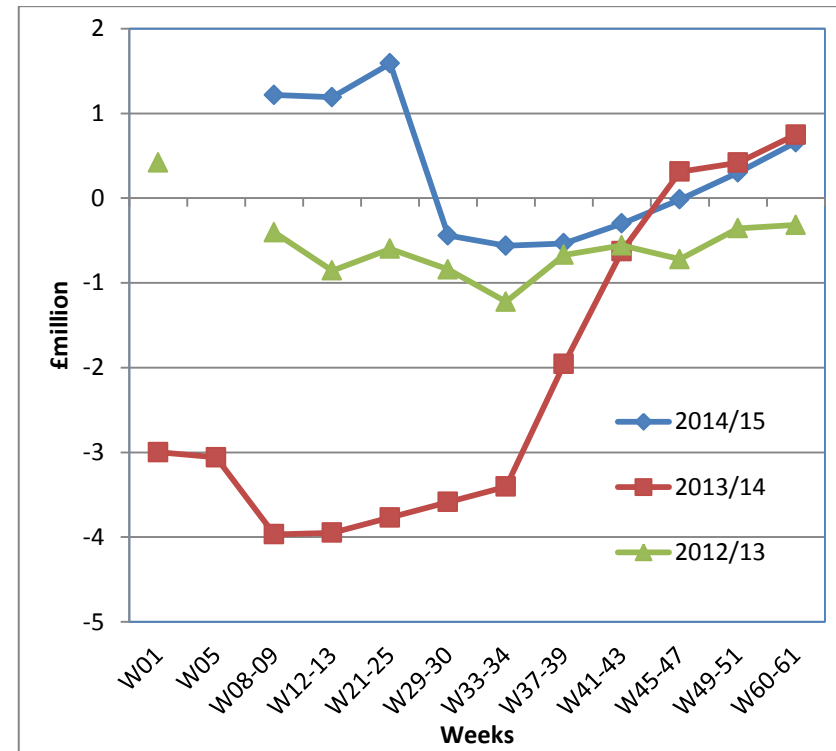
27. The main financial objective for SNH is to ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers. SNH operated within the

resource budgets for 2014/15 as detailed above. To allow funds to be redeployed to other areas of priority work within the Scottish Government, it was agreed that SNH would draw

## Financial management and sustainability

down all but £0.686m of the Resource DEL budget, allocated in 2014-15.

28. The initial DEL budget allocation was increased by £3.7 million, mainly due to an additional £5 million for peat land restoration and a number of other more minor transfers. Off-setting this was a transfer from SNH back to the Scottish Government directorate of £1.850 million to fund the delivery of the Scottish Rural Development Programme (SRDP).
29. In our Annual Audit Report in 2013/14 we commented on the high level of over-commitment in the project budget. We have again mapped the level of over-allocation compared to the two prior years. As can be seen from the graph, the level of early over-commitment has reduced significantly from 2013/14, and we conclude that appropriate financial management controls were operating throughout 2014/15 to prevent a repeat of the budget issues that existed part-way through 2013/14.



## 2014/15 financial position

30. At 31 March 2015 SNH's statement of financial position shows total taxpayers' equity of £24.3 million.
31. The financial position of SNH therefore remains stable with the body operating within its available income and funding (on an accounting and resource basis); an excess of total and current assets over liabilities and positive cashflows (taking into

## Financial management and sustainability

account Scottish Government grants).

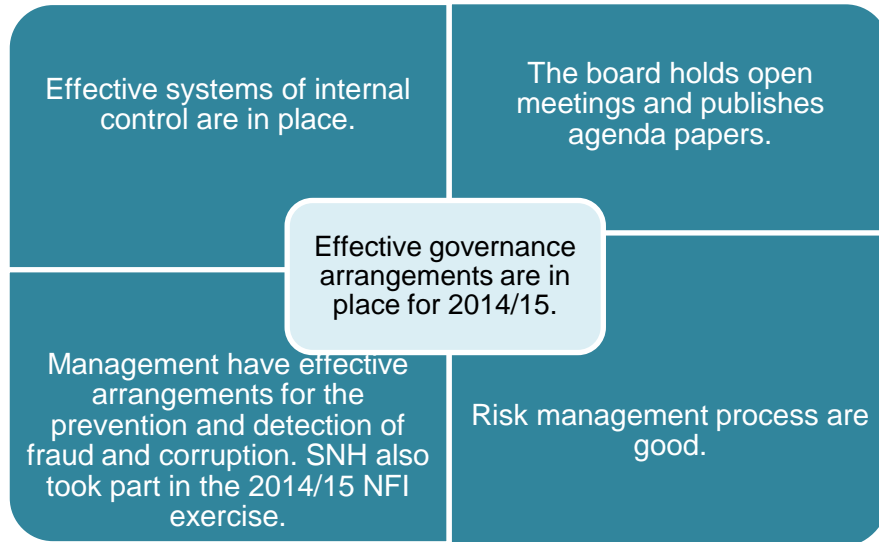
32. SNH has a financial plan, covering three years (2015/16 to 2017/18) in its Corporate Plan 2015-2018 which was approved by the Board in February 2015. The financial plan incorporates an assumption of “flat” Grant-In-Aid allocation (including non-cash and capital) of £53.1 million. The corporate plan also forecasts additional funding to cover peatland restoration funding and SNH’s role as lead partner in the European Regional Development Fund Green Infrastructure programme.
33. Annual business plans will incorporate more refined budgets for each of the 3 years from 2015/16 to 2017/18. The 2015/16 business plan was approved by the board in May 2015 and included expected allocation revisions and additional income streams..

## Financial management

34. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
  - the Head of Finance has sufficient status to be able to deliver good financial management
  - standing financial instructions and standing orders are comprehensive, current and promoted within the body
  - reports monitoring performance against budgets are accurate and provided regularly to budget holders

- monitoring reports do not just contain financial data but are linked to information about performance
  - members provide a good level of challenge and question budget holders on significant variances
35. On an annual basis, as part of the risk assessment stage of our audit, we reviewed the financial control environment (i.e. standing orders / financial regulations, scheme of delegation etc.) and concluded that these were satisfactory.
  36. In addition to this, as reflected within the Best value section of this report, we also carried out an exercise to determine the financial capacity within SNH. This involved collecting information on the following:
    - Organisational structure and the role of the chief financial officer
    - Financial strategy and sustainability
    - Budget monitoring & reporting
    - Quality of the operational finance function
    - Finance capacity within the organisation
    - Reporting.
  37. Based on our specific work during 2014/15; our accumulated knowledge, a review of board papers and through our attendance at committees, we conclude that SNH has strong financial management arrangements in place.

# Governance and transparency



## Corporate governance

- 38. The Board is responsible for ensuring that SNH both fulfils its statutory duties and meets the aims and objectives set by Scottish Ministers. The Accountable Officer (the Chief Executive) is responsible for safeguarding public funds and assets. As such the post-holder is required to act in accordance with the Framework Agreement and the Scottish Public Finance Manual.
- 39. SNH is managed by a Board of Non-Executive Members (appointed by the Scottish Government) to provide effective

leadership, direction, support and guidance to the organisation.

- 40. The Board is supported in its role by three standing committees as illustrated below:



- 41. The Scientific Advisory and Audit & Risk Management committees meet on a regular basis throughout the year to consider relevant matters. The Protected Areas Committee meets on an ad-hoc basis, determined by specific business

## Governance and transparency

need. While both the Audit & Risk Management and Protected Areas committees are populated entirely by SNH Board Members, the Scientific Advisory Committee is chaired by a Board Member with the other places filled by appropriately qualified appointees.

42. During 2014/15, the Chairman constituted a Board Finance Group (comprising two Board members) which meets with the Chief Financial Officer and Head of Finance on a monthly basis. The Group reviews financial and performance information and provides feedback to the Board on progress and risk.
43. We concluded that SNH has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

## Transparency

44. The Scottish Government's On Board guidance (<http://www.gov.scot/Publications/2015/04/9736/0>), for board members of public bodies was updated and reissued in April 2015. On Board states that boards should demonstrate high standards of corporate governance at all times including openness and transparency in decision making. It recommends boards should consider:
  - Holding an annual open meeting
  - Holding board meetings in public unless there is a good reason not to
  - Publishing summary reports and/or minutes of meetings
  - Inviting evidence from members of the public in relation to matters of public concern
  - Consulting stakeholders and users on a wide range of issues
  - Making corporate plans and the annual report widely available.
45. Audit Scotland also believes in transparency of financial reporting within the Annual Report and Accounts including:
  - A clear reconciliation between expenditure and the outturn against Scottish Government Resource budgets.
  - Identification of, and explanation of, any significant movements in budget during the year.
46. The open session parts of the SNH Board meetings (and those of the Scientific Advisory Committee and Protected Areas Committee) are open to the public to attend as observers. Agendas and reports for these open sessions are available on the SNH website (although we found that the Protected Areas Committee is not up to date).
47. The management commentary within the financial statements incorporates a clear reconciliation between the accounts and the resource outturns. Following audit recommendation, the

## Governance and transparency

management commentary also includes an explanation for significant resource budget movements during the year.

48. Overall we have concluded that SNH is open and transparent.

## Internal control

49. As part of our audit we reviewed the high level controls in a number of systems fundamental to the preparation of the financial statements. Our objective was to obtain sufficient audit evidence to support our opinion on the financial statements.

50. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the organisation's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

51. We reported our findings to the Director of Corporate Services and the Head of Finance on 22 April 2015 and the Audit & Risk Management Committee on 28 May 2015.

## Internal audit

52. Internal audit provides the Audit & Risk Management Committee and Accountable Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by

international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.

53. Our review of internal audit concluded that the internal audit service operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

54. The internal audit plan for 2014/15 was materially complete. We were able to place formal reliance on aspects of internal audit work in the following areas:

- New Grants Processes
- Corporate Governance
- Risk Management System.

## Arrangements for the prevention and detection of fraud

55. We assessed the arrangements for the prevention and detection of fraud during the planning phase of our audit. This involved a review of the SNH Fraud Policy and Fraud Response Plan, Whistleblowing Policy and arrangements in place to communicate these documents to all staff. We also reviewed the method employed for the reporting of instances of fraud to Members and found satisfactory arrangements exist.

56. We therefore conclude that there are effective arrangements

## Governance and transparency

for the prevention and detection of fraud.

### National Fraud Initiative in Scotland

57. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise led by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify circumstances (matches) that might suggest the existence of fraud or error.
58. Auditors are required to assess the arrangements that bodies have put in place to prevent and detect fraud, including how they approach the NFI exercise itself.
59. As part of this year's NFI exercise, SNH submitted Payroll and Creditors data and the matching process identified 678 records for investigation with 127 of these "recommended" for investigation. To date, 278 of the total matches have been investigated (including all "recommended" matches). No issues have been identified from the investigations to date and there are no issues of concern that we require to include in this report.

### Arrangements for maintaining standards of conduct and the prevention and detection of corruption

60. SNH has in place a range of activities designed to maintain

standards of conduct including the Standards of Conduct Policy for officers and a chapter within the "Board, Committees and Management Team Ways of Working for Members".

61. We recognise that SNH demonstrate good-practice in their process for updating the Register of Interests. This process extends to all SNH staff (through the iPeople HR system) and is renewed annually. Details for non-executive Board Members are contained within the financial statements.
62. Based on our review of the evidence we concluded that there are appropriate arrangements in place for the prevention and detection of corruption and we are not aware of any specific issues that we need to record in this report.



# Best Value

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## National performance audit reports

63. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2014/15, a number of reports were issued which are of direct interest. These are outlined in [appendix III](#).
64. SNH has sound processes in place to ensure that all relevant national performance reports are considered by the Audit and Risk Management Committee.
65. **Scotland's public finances - a follow-up audit: Progress in meeting the challenges.** This report was published in June 2014 and commented that, in setting budgets, public bodies need to focus more on their priorities, making clearer connections between planned spending and the delivery and measurement of outcomes. It recommended that public bodies should develop long-term (5-10 year) financial strategies to direct and control their finances.
66. **Update on developing financial reporting:** This update report published in March 2015 reviewed the principles of public financial management and provided an update on the actions the Scottish Government is taking to further develop financial reporting. The report concludes that the Scottish

Government and the public sector generally, have a good record of financial management and reporting. The Scottish Government has continued to improve and develop its financial reporting framework since we last reported. The report highlights that consolidated accounts for the whole of the Scottish public sector would help provide an overall picture of its financial position to strengthen understanding and transparency.

67. **Managing ICT contracts in central government: an update:** The update report published in June 2015 reviewed the Scottish Government's new assurance and oversight arrangements for central government ICT programmes. The report concluded that these arrangements have not been fully effective.
68. **Financial capacity (new study) -** Audit feedback through Annual Audit Reports indicates that reductions in staff numbers in public bodies may be affecting the capacity of back office functions, specifically finance. Consequently as part of our 2014/15 audit, we have collected information on financial capacity in all our audited bodies. The aim is to provide the Accounts Commission and the Auditor General with a summary of key issues or themes in respect of financial capacity. This may be used to support the development of Audit Scotland's future performance audit programme.

# Appendix I – Significant audit risks

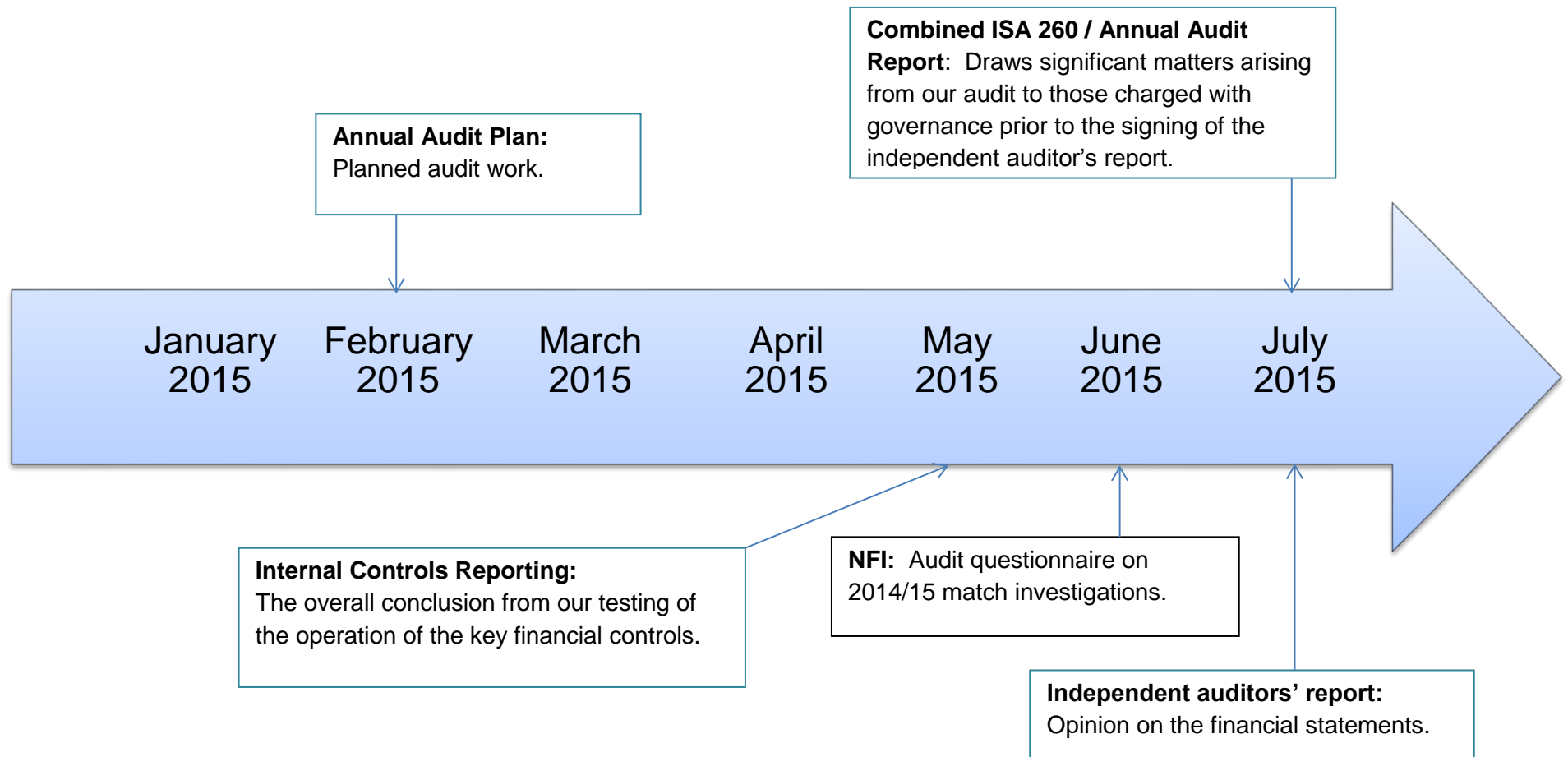
The table below sets out the audit risks, how we addressed each risk and our judgement in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
<b>Financial audit issues</b>		
<p><b>Risk of management override of controls</b> (Statement of Comprehensive Net Expenditure)</p> <p>ISA 240 (<i>The auditor’s responsibility to consider fraud in an audit of financial statements</i>) requires that the audit work is planned to consider the risk of fraud which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p> <p><i>There is a risk that fraud may occur through management override of control mechanisms.</i></p>	<ul style="list-style-type: none"> <li>• Detailed testing of journal entries.</li> <li>• Review of accounting estimates.</li> <li>• Evaluation of significant transactions that are outside the normal course of business (if applicable).</li> </ul>	<p>No issues have arisen as part of our audit work that would indicate management override of controls affecting the outturn or year end position.</p>
<p><b>2014/15 Budget Position</b></p> <p>In 2013/14 we reported difficulties arising from budget over-commitment. In 2014/15 there are additional financial pressures and SNH are also managing an additional grant area (peatland restoration).</p> <p><i>There is a risk that the financial position is increasingly difficult to manage leading to overspends at the 31 March.</i></p>	<ul style="list-style-type: none"> <li>• Establish the financial position and how this developed throughout 2014/15, including the management of commitments, through the weekly “numbers” reports.</li> </ul>	<p>We reviewed the weekly numbers reports for the year and established that over commitment of budget had not been an issue during 2014/15.</p>

## Appendix I – Significant audit risks

Audit Risk	Assurance procedure	Results and conclusions
<p><b>Peatland Restoration</b></p> <p>£5m additional grant-in-aid was allocated in September 2014 to encourage and support the restoration of peatland in Scotland. .</p> <p><i>There is a risk that grant conditions/requirements may not be fully met. This is exacerbated by the relatively short time available to plan, allocate and spend the grant monies.</i></p>	<ul style="list-style-type: none"> <li>• Establish the grant conditions</li> <li>• Review a sample of allocations from the grant to ensure compliance with the required grant conditions.</li> </ul>	<p>We liaised with Forestry Commission (largest recipient of the grant) to ensure spend was relevant to 2014/15.</p> <p>We reviewed processes to award peatland grants and tested year end accruals/.</p> <p>We are able to confirm that the peatland restoration spend was appropriate and complied with grant conditions</p>

## Appendix II – Summary of local audit reports 2014/15



# Appendix III – Summary of national reports 2014/15

