

# Scottish Natural Heritage

2016/17 Annual Audit Report



 AUDIT SCOTLAND

Prepared for Scottish Natural Heritage and the Auditor General for Scotland  
July 2017

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Key messages

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## Audit of the 2016/17 financial statements

- 1 The financial statements of Scottish Natural Heritage for 2016/17 give a true and fair view of the state of its affairs and of its net expenditure for the year.
- 2 The expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance, and the other information in the annual report and accounts was consistent with the financial statements and was prepared in accordance with legal requirements.

## Financial management and financial sustainability

- 3 Scottish Natural Heritage has effective arrangements in place for financial management. It operated within its Grant in Aid resource limits for 2016/17, underspending by £0.462 million. Once the underspend agreed with the Scottish Government (£0.5 million) is taken into account, a small overspend (£0.038 million) resulted.
- 4 Systems of internal control operated effectively in 2016/17 and there was good engagement with the NFI exercise.
- 5 Arrangements for identifying and recording potential conflicts of interest have been assessed as good practice as they cover all board members, directors and staff.
- 6 Scottish Natural Heritage's financial planning arrangements are continuing to develop and medium term financial planning is being used to consider the effects of decreasing resources and increasing savings requirements on the future delivery of services.

## Governance and transparency

- 7 Scottish Natural Heritage has appropriate arrangements in place to support good governance, accountability and scrutiny.
- 8 Overall, Scottish Natural Heritage is open and transparent in the way it conducts its business. Meetings of the Audit and Risk Management Committee (ARMC) are not open to the public and agendas, papers and minutes from these meetings are not published on the website. A summary report is, however, made regularly to the Board by the ARMC Chair and the resulting discussion is recorded in the Board minutes. The Board has agreed to consider whether there is scope to enhance transparency around the business of this particular committee.
- 9 Internal audit is effective and operates in accordance with the Public Sector Internal Audit Standards.

## Value for money

- 10 Scottish Natural Heritage has an effective performance management framework in place which supports the achievement of value for money.

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# Introduction

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1. This report is a summary of our findings arising from the 2016/17 audit of Scottish Natural Heritage.

2. The scope of our audit was set out in our Annual Audit Plan presented to the February 2017 meeting of the Audit and Risk Management Committee. This report comprises:

- an audit of the annual report and accounts
- consideration of the wider dimensions set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

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## Exhibit 1

### Audit dimensions



Source: Code of Audit Practice 2016

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3. The main elements of our audit work in 2016/17 have been:

- an interim audit of the Scottish Natural Heritage's main financial systems and governance arrangements, including a review of the Role of Boards;
- an audit of Scottish Natural Heritage's 2016/17 annual report and accounts including the issue of an independent auditor's report setting out our opinions.

4. Scottish Natural Heritage is responsible for preparing financial statements that give a true and fair view, for the accuracy of the other information in the annual report and accounts, and for establishing effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

5. Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), supplementary guidance, guided by the auditing profession's ethical guidance.

6. As public sector auditors we give independent opinions on the financial statements. We also review and report on the arrangements within Scottish Natural Heritage to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

7. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

8. This report raises matters from the audit of the annual report and accounts and risks or control weaknesses identified during the audit process. Communicating these does not absolve management of its responsibility to address the issues raised, and to maintain an adequate system of control.

9. As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee for the audit was set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

10. This report is addressed to both the board and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

11. We would like to thank all management and staff who have been involved in our work for their cooperation and assistance during the audit.

# Part 1

## Audit of 2016/17 financial statements



### Main judgements

**The financial statements of Scottish Natural Heritage for 2016/17 give a true and fair view of the state of its affairs and of its net expenditure for the year.**

**The expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance.**

**The other information in the annual report and accounts is consistent with the financial statements and was prepared in accordance with legal requirements.**

### Unqualified audit opinions

12. The annual report and accounts for the year ended 31 March 2107 were approved by the board on 27 July 2017. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements;
- an unqualified opinion on regularity of expenditure and income; and
- an unqualified audit opinion on the remuneration and staff report, performance report and governance statement.

13. Additionally, we are satisfied that there are no matters which we are required by the Auditor General to report by exception.

The annual report and accounts are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources.

### Submission of annual report and accounts for audit

14. We received the unaudited annual report and accounts on 31 May 2017, in line with our agreed audit timetable. The working papers provided with the unaudited financial statements were of a high standard and finance staff provided good support to the audit team which helped ensure the final accounts audit process ran smoothly.

### Risk of material misstatement

15. [Appendix 1](#) (page 19) provides a description of the risks of material misstatement that were identified during the planning process and how we addressed each risk in arriving at our opinion on the financial statements.

## Materiality

16. Materiality defines the maximum error that we are prepared to accept and still conclude that our audit objective has been achieved. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

17. Our initial assessment of materiality for the annual report and accounts was undertaken during the planning phase of the audit and is summarised in [Exhibit 2](#). Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

18. On receipt of the annual report and accounts we reviewed our original materiality calculations and concluded that they remained appropriate.

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## Exhibit 2

### Materiality values

Materiality level	Amount
<b>Overall materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of gross expenditure for the year ended 31 March 2017.	£0.49 million
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 65% of overall materiality.	£0.32 million
<b>Reporting threshold</b> – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 4% of overall materiality.	£20 thousand

Source: Audit Scotland

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## Evaluation of misstatements

19. A small number of presentational and monetary amendments to the accounts were identified during the course of our audit. These were discussed with senior finance officers who agreed to amend the financial statements. There are no unadjusted misstatements.

20. The two monetary adjustments had the following impact on the financial statements:

- trade receivables were reduced and trade payables increased by £0.095 million to reflect the final reconciliation of the EU project, Pearls in Peril, the figures for which were not available at the time the draft accounts were prepared
- the revaluation reserve balance was reduced and the general reserve balance was increased by £0.036 million due to errors identified within the complex model developed by finance staff to calculate the prior period adjustment required to ensure the balance on the revaluation reserve equalled the total of the revaluation balances on the individual assets held by Scottish Natural Heritage.



21. The total value of misstatements (£0.131 million) did not exceed our performance materiality level (£0.320 million) and so we did not need to revise our audit approach or perform any additional testing.

### Significant findings from the audit

22. International Standard on Auditing (UK and Ireland) 260 requires us to communicate significant findings from the audit to you. These are summarised in [Exhibit 3](#).

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## Exhibit 3

### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Pearls in Peril Grant adjustment</b></p> <p>Trade receivables and trade payables were overstated by £0.095 million due to a delay in finalising the figures for the reconciliation of the Pearls in Peril grant.</p>	<p>The audited financial statements have been amended to reflect this misstatement. There was no impact on total taxpayers' equity.</p>
<p><b>2. Property, Plant &amp; Equipment</b></p> <p>The revaluation reserve balance was overstated and the general reserve balance was understated by £0.036 million due to errors identified within the complex model developed by finance staff to calculate the prior period adjustment required to ensure the balance on the revaluation reserve equalled the total of the revaluation balances on the individual assets held by Scottish Natural Heritage</p>	<p>The audited financial statements have been amended to reflect this misstatement between reserves. There was no impact on total taxpayers' equity.</p>

Source: Audit Scotland

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### Other findings

23. As part of our audit of property, plant and equipment we reviewed how Scottish Natural Heritage accounted for revaluations of these assets within their asset register. The methodology followed was one of two methodologies permitted by International Accounting Standard 16. Following discussion with finance staff, it was agreed that, with effect from 2016/17, the board would adopt the alternative methodology. As a result, a number of the disclosures within Note 14 (Property, Plant and Equipment) to the financial statements have been amended but there has been no impact on the property, plant and equipment value included in the accounts.

# Part 2

## Financial management



### Main judgements

Scottish Natural Heritage has effective arrangements in place for financial management. It operated within its Grant in Aid resource limits for 2016/17, underspending by £0.462 million. Once the underspend agreed with the Scottish Government (£0.5 million) is taken into account, a small overspend (£0.038 million) resulted.

Systems of internal control operated effectively in 2016/17.

There was good engagement with the NFI exercise.

Arrangements for identifying and recording potential conflicts of interest have been assessed as good practice as they cover all board members, directors and staff.

### Financial performance in 2016/17

24. The main financial objective for Scottish Natural Heritage is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers. Scottish Natural Heritage reported an outturn of £47.208 million for 2016/17, underspending its overall budget by £0.462 million and so met this objective in 2016/17. Financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#).

### Exhibit 4

Performance against DEL and AME in 2016/17

Performance	Initial budget £'000	Final budget £'000	Actual outturn £'000	Overspend/ (underspend) £'000
Resource DEL	45,397	46,470	46,117	(353)
Capital DEL	1,200	1,200	1,091	(109)
<b>Total DEL</b>	<b>46,597</b>	<b>47,670</b>	<b>47,208</b>	<b>(462)</b>
Annually managed expenditure (AME)	-	192	136	(56)
<b>Total Allocation</b>	<b>46,597</b>	<b>47,862</b>	<b>47,344</b>	<b>(518)</b>

Source: Scottish Government Autumn and Spring Budget Revision letter to Scottish Natural Heritage and Scottish Natural Heritage Annual Report and Accounts 2016/17.

25. A number of adjustments were made to the original budget. These include an additional £0.400 million to fund peatland restoration, an additional £0.373 million for various other initiatives, and the surrender of £1.500 million to support Scotland's Rural Development Programme.

### **Budget underspend requested by the Scottish Government**

26. During 2016/17 the Scottish Government asked Scottish Natural Heritage to underspend its budget by £0.500 million. The £0.462 million underspend above includes this authorised underspend as the budget allocation was not adjusted by the Scottish Government. Once the agreed underspend is taken into account, Scottish Natural Heritage overspent its DEL by £0.038 million.

### **Internal controls**

27. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant for the production of the financial statements. Our objective is to gain assurance that Scottish Natural Heritage has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

28. Our findings were included in an interim audit report presented to the Audit and Risk Management Committee in May 2017. We concluded that the controls were operating effectively. No significant internal control weaknesses were identified during the audit which could affect Scottish Natural Heritage'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.

### **Budgetary processes**

29. We also reviewed Scottish Natural Heritage's process for preparing budget information and the budget monitoring reports presented to the Board. We concluded that the arrangements in place were sufficiently robust to provide effective financial information for management decision-making and scrutiny of the finances of the body.

### **Prevention and detection of fraud and irregularity**

30. We assessed Scottish Natural Heritage's arrangements for the prevention and detection of fraud. Our audit work covered a number of areas such as whistleblowing and review of the fraud policy and response plan document.

31. We concluded that Scottish Natural Heritage is proactive in promoting fraud awareness and had appropriate and adequate arrangements in place for fraud detection and prevention during 2016/17. There were no instances of fraudulent activity investigated during the year.

### **National fraud Initiative**

32. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise co-ordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or error (Exhibit 5).

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Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

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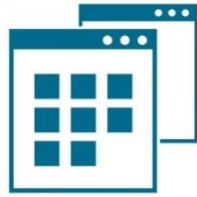
## Exhibit 5

Total number of matches



531

Number recommended for investigation



92

Completed/closed investigations



98

Source: NFI System, SNH

33. As part of the 2016/17 NFI exercise, 531 matches were identified for Scottish Natural Heritage, of which 92 were categorised as high quality matches. Of these, 89 have been fully investigated and concluded together with a further 9 non-priority matches. As at the date of writing, 3 high quality matches, which were not received until May 2017, had still to be investigated. No frauds have been identified to date.

34. The Director of Corporate Services was kept updated on the emerging results throughout the exercise. A full report of the findings, including the completed self-assessment questionnaire, is due to be presented to the Audit and Risk Management Committee on 23 August 2017.

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

35. We reviewed the arrangements in place to maintain standards of conduct including the staff Code of Conduct and board members' Code of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

36. Scottish Natural Heritage requires all board members to update their register of interests on a regular basis. Quarterly reminders are sent to ensure interests are reviewed and updated within one month. In addition, all staff are required to review and update their register of interests annually or as soon as changes have occurred. This enables early identification of any circumstances which may pose the potential for a conflict of interest. We consider that these arrangements represent good practice as all board members, directors and staff are included in the process.

# Part 3

## Financial sustainability



### Main judgements

**Scottish Natural Heritage's financial planning arrangements are continuing to develop and medium term financial planning is being used to consider the effects of decreasing resources and increasing savings requirements on the future delivery of services.**

#### 2016/17 financial position

37. The Statement of Financial Position summarises what is owned and owed by Scottish Natural Heritage. This shows taxpayers' equity – an accounting measurement of the amount invested that has continuing public benefit. It shows how much of this has arisen from the application of revenues and that which has resulted through changes over time in the value of physical assets.

38. The financial statements show that Scottish Natural Heritage:

- has net assets of £23.692 million. This is an increase of £0.596 million compared to the 2015/16 position and is largely attributable to increases in the valuation of property, plant and equipment (£0.542 million), intangible assets (£0.124 million), trade and other receivables (£0.145 million) and a decrease in trade and other payables (£2.390 million) offset by a decrease in cash and cash equivalents (£2.624 million)
- has an excess of current liabilities over current assets (£1.716 million). Management have considered the budget and associated grant in aid allocation from the Scottish Government for 2017/18 and consider that Scottish Natural Heritage has adequate resources to continue in operational existence for the foreseeable future. The accounts have, therefore, been prepared on a going concern basis. We agree with this assessment.

#### Financial planning

39. The 2017/18 budget shows a challenging position, reflecting the impact of financial pressures, not least the decrease in resource allocation of some £1.23 million to £46.45 million from the previous year level of £47.67 million. The most recent budget monitoring report (as at 30 June 2017) forecasts an overspend of £0.917 million on the operating budget as at 31 March 2018. This is being managed using established performance measures and controls.

#### Medium to long term financial planning

40. In last year's Annual Audit Report we recommended that Scottish Natural Heritage should develop a long term financial strategy (5 years +) supported by clear and detailed financial plans (3 years +). Plans should set out scenario plans (best, worst, most likely) with a clear assessment of the impact of budget assumptions on activity and any residual risks.

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

41. The refresh of the Corporate Plan, covering the period 2017/2022, provided the opportunity for management to consider the financial sustainability of the organisation over a five year period. Scenario planning was used to consider alternative financial outlooks (ranging from 0 to 5% reduction in the board's cash settlement). The impact on the baseline budget of each of these scenarios was then considered along with the potential implications for ongoing work, and the capacity of the organisation to take on new challenges and initiatives.

42. Future financial settlements will continue to challenge the Board. They, along with other central government bodies, have recently been required by the Scottish Government to submit deliverable proposals to reduce resource DEL spending in 2018/19 by 5%, 10%, 15% and 20% against the resource DEL 2017/18 baseline budget with further reductions planned in 2019/20. Scottish Natural Heritage are currently using their medium term financial planning model to work through the impact of these scenarios on their core business.

# Part 4

## Governance and transparency



### Main judgements

**Scottish Natural Heritage has appropriate arrangements in place to support good governance, accountability and scrutiny.**

**Internal audit is effective and operates in accordance with the Public Sector Internal Audit Standards.**

**Overall, Scottish Natural Heritage is open and transparent in the way it conducts its business. Meetings of the Audit and Risk Management (ARMC) Committee are not open to the public and agendas, papers and minutes from these meetings are not published on the website. A summary report is, however, made regularly to the Board by the ARMC Chair. Board members have the opportunity to ask questions and the discussion is recorded within the minutes of the Board. The Board has agreed to consider whether there is scope to enhance transparency around the business of this particular committee.**

### Governance arrangements

43. As part of the wider review of governance arrangements across the public sector, we completed a follow-up of Audit Scotland's 'Role of Boards' national report, published in September 2010. This involved review of documentation and discussions with key officers.

44. 2016/17 saw a significant change to the membership of the Board with 5 (50%) out of 10 members being newly appointed in April 2016 and a new chair of the Board being appointed with effect from May 2017. A number of training events were held in 2016/17 to help members settle into their new roles and responsibilities

45. The Senior Management Unit is well established in its role of supporting and developing the Board and related committees, and are pro-active in encouraging the adoption of good governance principles and practices. This, combined with the commitment of the Board members to personal development, promotes effective scrutiny and challenge in relation to policy decisions and performance.

46. We concluded that, overall, Scottish Natural Heritage has appropriate arrangements that support good governance, accountability and scrutiny.

## Governance statement

47. Under the Treasury's Financial Reporting Manual (FRm), Scottish Natural Heritage must prepare an annual governance statement within the annual report and accounts. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the statement and provides assurances around the achievement of the organisation's strategic objectives.

48. The SPFM does not prescribe a format for the annual governance statement, but sets out minimum requirements for central government bodies. Within Scottish Natural Heritage a range of assurances are obtained from a variety of sources throughout the organisation. The most significant of these being the completion, by all Heads of Service, of Governance Tables on a quarterly basis. Each year Internal Audit assess the board's corporate governance arrangements (including the Governance Tables) and prepares a detailed report to support the disclosures in the governance statement.

49. We concluded that the 2016/17 governance statement complies with the guidance issued by the Scottish Ministers and, based on our knowledge and the work performed, presents a comprehensive picture of governance arrangements and matters.

## Internal audit

50. Internal audit provides the Accountable Officer with independent assurance on Scottish Natural Heritage's overall risk management, internal control and corporate governance processes.

51. The internal audit function is carried out in-house with the option to supplement resource through a flexible contract with a third party, although this was not required during the year. As reported in our Annual Audit Plan, we carried out a review of the adequacy of the internal audit function and concluded that it operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

52. To avoid duplication of effort we place reliance on the work of internal audit wherever possible. In 2016/17 we considered internal audit report findings on corporate governance arrangements, risk management and workforce planning as part of our wider dimension work.

## Transparency

53. Transparency means that stakeholders, including the public, have access to understandable, relevant and timely information about how the board is taking decisions and how it is using public resources.

54. All meetings of the Board, the Scientific Advisory Committee and the Protected Areas Committee are held in public with agendas, papers and minutes published on SNH's website. We noted that Audit and Risk Management Committee (ARMC) meetings are not held in public and that agendas, papers and minutes from these meetings are not published on the website. A summary report is, however, made regularly to the Board by the Chair of the ARMC. Board members have the opportunity to ask questions and the discussion is recorded within the minutes of the Board meeting. The Board has agreed to consider whether there is scope to enhance transparency around the business of this particular committee.

55. Overall, we concluded that the board conducts its business in an open and transparent manner. There is, however, scope to improve transparency around the Audit and Risk Management Committee.



# Part 5

## Value for money



### Main judgements

**Scottish Natural Heritage has an effective performance management framework in place which supports the achievement of value for money.**

56. Value for money is a key element of our audit approach. In 2016/17 we did not identify any significant value for money risks during our planning and therefore we did not undertake any specific value for money work this year. We will keep this area under review over the five-year audit appointment and will report as appropriate.

#### Performance management

57. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value. Where such requirements are not specified we may, in conjunction with Scottish Natural Heritage, agree to undertake local work in this area.

58. Scottish Natural Heritage has a three year (2015-2018) Corporate Plan which sets out nineteen long term outcomes to help achieve the four strategic aims set out in its Corporate Strategy. An annual business plan details how it will deliver the objectives through four portfolios each with a sub-set of activities.

59. A comprehensive Performance Report covering the progress being made towards achieving the outcome measures in the Corporate Plan and the deliverables for the Business Plan is presented to the Board on a quarterly basis. Performance is reported on a traffic light system covering the four Corporate Plan portfolio areas and the nineteen outcome measures identified as being critical to success. Information provided includes trend analysis, specific performance issues and actions being taken to improve performance. Board members also receive supplementary reports on specific aspects of performance such as workforce planning and financial performance against budget which enable them to focus on areas of key risks that have previously been identified.

60. The 2016/17 quarter 4 performance report highlights fourteen of the Corporate Plan outcome measures were rated as 'green' (on track), with the remaining five assessed as amber (minor slippage). Progress against the portfolio outcomes and key deliverables across the fifteen activities within the portfolio areas are also measured on a similar basis with 87% of key deliverables rated as 'green' by 31 March 2017. Corporate risks and opportunities are also highlighted along with key staff indicators and the financial position against the budget.

61. We concluded that Scottish Natural Heritage has an effective performance management framework in place which supports the achievement of value for money and continuous improvement in the way services are delivered.

Value for money is concerned with using resources effectively and continually improving services.

## **National performance audit reports**

62. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2016/17, we published a number of reports which are of direct interest to the board. These are outlined in Appendix 2 accompanying this report.

63. The Scottish Public Finance Manual requires that the Accountable Officer formally considers a proportionate response to relevant national reports issued by Audit Scotland. In order to meet this requirement, the Head of Internal Audit summarises Audit Scotland's main reports and bulletins that relate to the work of Scottish Natural Heritage and prepares a response for the Accountable Officer to consider and comment on. These are also circulated to relevant officers and presented on a quarterly basis to the Audit and Risk Management Committee.

# Appendix 1

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating to our wider responsibility under the Code of Audit Practice 2016.

Audit Risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p>1 <b>Management override of controls</b></p> <p>ISA 240 requires that 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 in order to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Substantive testing of transactions to confirm that income and expenditure has been accounted for in the correct financial year.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>We did not identify any issues as a result of our audit work that would indicate management override of controls affecting the year end position.</p>
<p>2 <b>Risk of fraud over income</b></p> <p>ISA 240 requires auditors to presume a risk of fraud where income streams are significant (excluding Scottish Government funding). Scottish Natural Heritage receives a significant amount of income (£3.4 m) from third parties. The extent and complexity of income means that there is an inherent risk of fraud.</p>	<p>Analytical procedures on income streams.</p> <p>Detailed substantive testing of revenue transactions focusing on the areas of greatest risk.</p>	<p>We did not identify any issues as a result of our audit work that would indicate the risk of fraud over income affecting the year end position.</p>
<p>3 <b>Risk of fraud over expenditure</b></p> <p>ISA 240 and the Code of Audit Practice require auditors to consider the risk of fraud over certain types of public sector expenditure. This includes grants and other claims made by individuals and organisations on the public purse. Scottish Natural Heritage incurs significant expenditure on grants and research.</p>	<p>Review of key controls over the processing and payment of grants.</p> <p>Substantive testing of grant expenditure.</p> <p>Review action taken to investigate and clear data matches resulting from the National Fraud Initiative exercise.</p>	<p>Our controls work did not identify any issues with the system for processing or paying grants.</p> <p>Our substantive testing of grant expenditure did not identify any issues.</p> <p>Our work on following-up action taken to investigate and clear data matches did not identify any issues.</p>





















Audit Risk	Assurance procedure	Results and conclusions
	Undertake performance audit work on European funding.	Data for Audit Scotland's performance audit on European funding was submitted and will be used to identify the potential impact of the withdrawal of this funding across the central government sector in Scotland.
<p><b>4 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of non-current assets and provisions. This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Completion of 'review of the work of an expert' programme for the professional valuer.</p> <p>Focused substantive testing of provisions.</p>	<p>We reviewed the valuations of land and property which were prepared by management's experts. We found these judgements to be sound and, as such, were able to place reliance on the experts' work.</p> <p>We also undertook focused substantive testing on in year movements on provisions (including the new provision disclosed in 2016/17). No issues were identified.</p>
<p><b>5 Non-current assets</b></p> <p>Recent discussions with finance staff have indicated that some assets that should have been capitalised in prior years may not have been capitalised. The risk of misstatement in the financial statements is, therefore, increased.</p>	<p>Review the work undertaken by finance staff to identify any assets which meet the definition of capital expenditure but have not been capitalised in previous years.</p> <p>Focused substantive testing of significant purchases.</p>	<p>Finance staff identified one asset (the visitor Centre on the Isle of May) that meets the definition of capital expenditure but had not been capitalised in previous years. The net book value of this (£66k) was included in the unaudited accounts as a prior period adjustment.</p> <p>Our review of significant purchases did not identify any other assets requiring capitalisation.</p>
<p><b>4 Revaluation reserve</b></p> <p>The balance on the revaluation reserve should equal the total of the revaluation balances on the individual assets held by Scottish Natural Heritage. There is uncertainty as to whether this is currently the case and so there is an increased risk of misstatement in the financial statements.</p>	<p>Review the list of individual assets and confirm that the total agrees to the Revaluation Reserve balance included in the financial statements.</p>	<p>The unaudited accounts included a prior period adjustment of £4.026 million between the revaluation reserve and the general reserve. Our review of the model used to calculate this adjustment identified some errors which increased the adjustment required by £36,000.</p> <p>See Part 1 of this report (paragraph 20 and Exhibit 3 (2))</p>

Audit Risk	Assurance procedure	Results and conclusions
<b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b>		
<p>5 <b>Governance and transparency</b></p> <p>In September 2010, Audit Scotland published a report on 'The role of boards'. The report highlighted the need for Boards to demonstrate strong leadership and strategic direction. There is a risk that Scottish Natural Heritage cannot demonstrate that it has effective governance and scrutiny arrangements in place.</p>	<p>Follow up our 2010 'Role of Boards' report</p>	<p>See Part 4 of this report (paragraphs 43 to 46).</p>
<p>6 <b>Financial Sustainability and Financial Management</b></p> <p>In June 2014, Audit Scotland reported on Scotland's Public Finances and identified that financial planning improvements were required by public bodies.</p> <p>The outcome of the EU referendum led to uncertainty over future European funding, which is a significant source of income for Scottish Natural Heritage.</p>	<p>Review progress in developing a five year financial strategy.</p> <p>Undertake performance work on European funding.</p>	<p>See Parts 2 and 3 of this report</p> <p>Data for Audit Scotland's performance audit on European funding was submitted and will be used to identify the potential impact of the withdrawal of this funding across the central government sector in Scotland.</p>

# Appendix 2

## Summary of National performance reports 2016/17



<b>Apr</b>			
<b>May</b>	 Common Agricultural Policy Futures programme: an update		
<b>Jun</b>	 South Ayrshire Council: Best Value audit report	 The National Fraud Initiative in Scotland	
<b>Jul</b>	 Audit of higher education in Scottish universities	 Supporting Scotland's economic growth	
<b>Aug</b>	 Maintaining Scotland's roads: a follow-up report	 Superfast broadband for Scotland: a progress update	 Scotland's colleges 2016
<b>Sept</b>	 Social work in Scotland	 Scotland's new financial powers	
<b>Oct</b>	 Angus Council: Best Value audit report	 NHS in Scotland 2016	
<b>Nov</b>	 How councils work – Roles and working relationships in councils	 Local government in Scotland: Financial overview 2015/16	
<b>Dec</b>	 Falkirk Council: Best Value audit report	 East Dunbartonshire Council: Best Value audit report	
<b>Jan</b>			
<b>Feb</b>	 Scotland's NHS workforce		
<b>Mar</b>	 Local government in Scotland: Performance and challenges 2017	 i6: a review	 Managing new financial powers: an update

### The following reports may be of particular interest

The National Fraud Initiative in Scotland – June 2016

Supporting Scotland's economic growth – July 2016

Scotland's new financial powers – September 2016

Managing new financial powers: an update – March 2017

# Scottish Natural Heritage

## 2016/17 Annual Audit Report

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