Forestry Commission Scotland and Forest Enterprise Scotland

Annual report on the 2011/12 audit

AUDIT SCOTLAND

Prepared for Forestry Commission Scotland, Forest Enterprise Scotland and the Auditor General for Scotland

October 2012

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.

Contents

Key messages

2011/12

We have given an unqualified opinion that the financial statements of Forestry Commission Scotland (FCS) and Forest Enterprise Scotland (FES) for 2011/12 give a true and fair view of the state of the bodies' affairs and of their net income/ expenditure for the year.

The FCS financial outturn was significantly better than the budgeted net expenditure, due to a gain of £354m on biological assets.

FES achieved a minor in-year deficit. A substantial decrease in FCS grant funding since last year was offset by an increase in timber income, due to higher market price.

Outlook

A change in the accounting treatment for national forest estate is planned for 2012/13 and this will coincide with a full professional valuation. The national forest estate will be moved from FCS to FES. An explanation of this change in accounting policy and restated comparatives for 2011/12 will be required for the 2012/13 financial statements.

There are many potential governance and structure issues affecting both FCS and FES going forward. In April 2013 Forestry Commission Wales will become part of the new Welsh environment body, which means that the Forestry Commission will cease to exist as a Great Britain entity. In addition, new management and governance arrangements have been proposed for the Forestry Commission England and the Director General of the Forestry Commission has recently announced his intention to retire. Management are currently assessing potential implications for FCS and FES.

Introduction

1. This report is the summary of our findings arising from the 2011/12 audits of Forestry Commission Scotland (FCS) and Forest Enterprise Scotland (FES). The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audits, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.

2. A number of reports have been issued in the course of the year in which we make recommendations for improvements (Appendix A). We do not repeat all of the findings in this report, but instead focus on the financial statements and any significant findings from our wider review of FCS and FES.

3. Appendix B is an action plan setting out the high level risks we have identified from the audits. Management have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that FCS and FES understand their risks and have arrangements in place to manage these risks. The Management Boards and Accountable Officers should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.

4. This report is addressed to FCS, FES and the Auditor General and should form a key part of discussions with the Audit and Risk Committee as soon as possible after the formal completion of the audit of the financial statements. This report should be available to the Scottish Parliament, other stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.

5. This report will be published on our website after consideration by the Audit and Risk Committee and after the financial statements have been laid before parliament.

6. The management of audited bodies are responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audits of the financial statements or of risks or weaknesses does not absolve management from their responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

7. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.

8. We are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
   - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
   - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
   - the regularity of the expenditure and income.

9. Auditors review and report on, as appropriate, other information published with the financial statements, including the management commentary, annual governance statement and remuneration report. This section summarises the results of our audits on the financial statements.

Audit opinions

10. We have given unqualified opinions that the 2011/12 financial statements of both FCS and FES give a true and fair view of the state of the bodies' affairs and of their net operating surplus/ deficit for the year.

11. FCS and FES are required to follow the 2011/12 Government Financial Reporting Manual (the FReM) and we confirmed that the financial statements had been properly prepared in accordance with the FReM. We also confirmed that the relevant parts of the remuneration reports had been properly prepared and that information given in the remuneration reports as well as in annual report and finances sections is consistent with the financial statements.

12. We reviewed the governance statements and concluded that they comply with Scottish Government guidance.

Regularity

13. We also confirmed that the expenditure and income in the financial statements was in accordance with applicable legislation and Ministerial guidance, the Budget (Scotland) Act for 2011/12 and legislation governing sums paid out of the Scottish Consolidated Fund.

Whole of government accounts

14. The whole of government accounts (WGA) is the consolidated financial statements for all branches of government in the UK. FCS and FES unaudited consolidation packs were submitted on the required date and the audited return was completed by the audit deadline of

24 August 2012. We found no significant errors in the consolidation pack or the incorporated WGA return.

15. FCS and FES submitted consolidation packs to the Treasury WGA team with Forestry Commission Wales and Forest Enterprise England. Forestry Commission Great Britain/ England was, for the first time, part of the Department for Environment, Food and Rural Affairs (DEFRA) consolidation.

Sustainability Reporting

16. From 2011/12, all relevant bodies were encouraged to produce a sustainability report in accordance with the Scottish Government's Public Sector Sustainability Reporting Guidance (January 2012). This guidance is non-mandatory, however it represents good practice and central government bodies were encouraged to adhere to it.

17. The FCS and FES sustainability report for 2011/12 has been included in the Annual Report and is therefore covered by the consistency element of our audit opinion. We have been advised that a separate sustainability report will be produced and published on the Forestry Commission's website for 2013/14.

Accounting issues

Accounts submission

18. The full unaudited financial statements and supporting documentation were submitted for audit on 6 June 2012, in accordance with the pre-agreed timetable, and the audit fieldwork was completed on 10 July. The working papers, provided with the financial statements, were of a high standard, with exception of two areas for improvement (see the following paragraph) and the staff provided good support to the audit team, enabling all outstanding points to be cleared. Matters arising from the audit were discussed and agreed on a regular basis with senior officers and a revised set of financial statements, incorporating audit amendments, was completed on 12 July.

19. The system report, which should provide a breakdown of the FES sales ledger control account balance of £17.7m, was not prepared at 31 March 2012. However, a subsequent print and reconciliation was provided in July which enabled us to conclude on the accuracy and completeness of the amount in the financial statements. Officers have amended the accounts closedown procedures to ensure this report is run at 31 March in future. Officers have also agreed to provide an additional reconciliation schedule between the ledger and the financial statements for the 2012/13 financial statements audit. This will help the audit team confirm that all ledger entries had been appropriately included in the financial statements.

20. A report covering the key matters arising from the financial statements audit (the International Standard on Auditing (ISA) 260 report) was issued on 13 July 2012 and presented to the Audit Committee on 20 July. The financial statements were signed by the Accountable Officers on 20 July as recommended by the Audit and Risk Committee.

Presentational and monetary adjustments to the unaudited accounts

21. The only significant change to the financial statements as a result of the audit process was the adjustment within the FCS Statement of Cash Flows. The net cash flow from operating activities was reduced by £354m and there was a corresponding increase in the net cash flow from investing activities. This was reported in our ISA 260 report which was presented to the Audit and Risk Committee on 20 July 2012.

22. A number of minor presentational and disclosure adjustments were also made as a result of our review of the disclosures required by the FReM.

Prior year adjustments

23. There was one change to the accounting framework (FReM) in 2011/12, which has been reflected in the financial statements as a prior period adjustment. Grants and donated assets are now recognised immediately, unless there is a condition that the recipient has not satisfied which would lead to grant repayment. Most grants should now be recognised as income and the government grant reserve and donated asset reserve no longer exist. FCS and FES accounting policies reflect this change and appropriate amendments were made to the prior year statements. As a result, the net surplus for the year was increased by £0.059m.

24. In addition, income from Christmas tree sales was incorrectly classified in the 2010/11 FES Statement of Comprehensive Net Expenditure. As a result, £0.427m has been reclassified as Communities, Recreation & Tourism income. The 2010/11 net surplus was unaffected by this restatement.

FES - The valuation of timber inventories and work-in-progress

25. As in previous years, the total valuation of felled timber at roadside and at stump (£2.5m in 2011/12) is based on a Forest District (FD) average "unit price" for “standing sales clear fell” sale category. As reported in our ISA 260 report, there is a risk that this method of valuation does not accurately reflect the value of timber inventories and work-in-progress because it relates to the price of **uncut** timber. We have accepted that the use of the average provides an acceptable approximation for 2011/12. However, going forward, management have committed to review the valuation methodology and provide an updated valuation of 2012/13 felled timber inventories in time for this to be incorporated in period nine interim financial statements. Information will be collated on a contract basis which will enable the analysis of inventories by product type and relevant unit price.

Action Point 1

Outlook

26. No significant changes are currently expected to the reporting framework applicable to the FCS and FES (i.e. the FReM) for next year (2012/13). Looking to the longer term, from 1 January 2013 the introduction of the following international financial reporting standards (IFRSs) will become effective:

- IFRS 10 - consolidated financial statements (replacing IAS27)
- IFRS11 - joint arrangements (replacing IAS31)
- IFRS12 - disclosure of interest in other entities (replacing IFRS12)
- IFRS 13 - fair value
- The impact of these longer term changes on FCS and FES has not yet been assessed.

Accounting for the national forest estate

27. When FES was established in 2004, the national forest estate was initially shown on its statement of financial position. However, as FES was considered to be the "manager" rather than the "owner" of the estate, the national forest estate was transferred to FCS and has been accounted for in the FCS financial statements ever since. At that time the auditors expressed reservations over this change as the asset and cost of timber sold (FCS) were separated from the income and costs of felling (FES).

28. Senior management have reconsidered the accounting treatment for national forest estate in July this year and have decided to move the national forest estate back to FES during 2012/13. This will coincide with a full professional valuation of the forest estate which will take place in the last quarter of the 2012/13 financial year.

29. We are supportive of this change in accounting policy as this will remove the disparity between forest assets and the income generated from their sale, with FES representing the trading activities in full and FCS showing forestry policy funding more clearly. It will also bring the accounting treatment in Scotland in line with that in England. The rationale for this change in accounting policy will need to be explained in the 2012/13 FCS and FES financial statements and restated comparatives (2011/12) will be required.

Action Point 2

Financial position

30. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.

31. We consider whether audited bodies have established adequate arrangements and examine:
    - financial performance in the period under audit
    - compliance with any statutory financial requirements and financial targets
    - ability to meet known or contingent, statutory and other financial obligations
    - responses to developments which may have an impact on the financial position
    - financial plans for future periods.

32. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

33. The Scottish Government provides FCS and FES with a budget allocation for the year, which originates from the Spending Review Settlement and is subsequently passed in the Scottish Parliament as a Budget (Scotland) Act, authorising the Scottish Government's spending plans for the year. During the year revisions are approved in the autumn and spring budget revisions. FCS & FES are expected to manage their budgets in accordance with the Financial Memorandum and Scottish Public Finance Manual and ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers.

Annual outturn - FCS

34. The FCS statement of comprehensive net income for 2011/12 shows net income of £260m. Overall outturn, including capital expenditure, shown in the Statement of Parliamentary Supply, is £257m (**net income**). This was £319m better than budgeted **net expenditure**, with the underspend attributed to a gain of £354m on biological assets. The most significant elements of FCS costs of £121m were:
    - programme expenditure on grants paid to woodland owners of £16m
    - forestry development programmes of £10m
    - the book value of felled timber of £36m
    - FES funding of £30m.

Annual outturn - FES

35. The FES statement of comprehensive net expenditure for 2011/12 shows a minor deficit of 0.057m. Despite a £9.5m decrease in FCS grant funding on last year. There was a similar increase in timber income (see the following paragraph) which contributed to the outturn. The largest elements of FES expenditure of £103m were:

- timber harvesting and marketing of £22m
- forest protection and maintenance costs of £29m
- communities, recreation and tourism expenditure of £19m.

36. Income from sales of timber was £59m, an £11m (22%)increase on 2010/11 and a £19m (48%) increase on 2009/10. This was mainly attributable to a substantial increase in the price for timber during the previous two years. This is consistent with the revaluation gains outlined in paragraph 34.

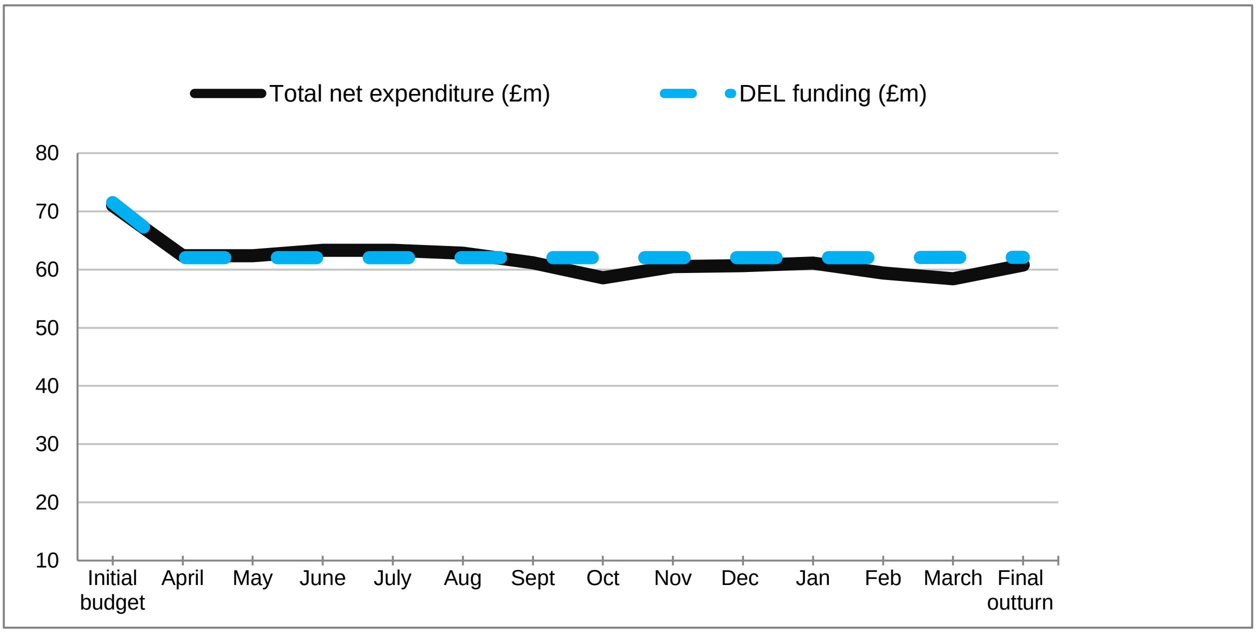
Budgetary control

37. There are good arrangements for budget setting and monitoring in place at FCS and FES, with management closely monitoring income and expenditure against budget and reporting financial results to the FCS and FES Management Boards on a monthly basis. Quarterly budget monitoring reports are also presented to the National Committee for Scotland which is responsible for giving strategic direction to all of the Forestry Commission's activities in Scotland on behalf of Scottish Ministers.

Budget reporting

38. The initial budget of £71.5m was amended in the Scottish Government's spring budget revision to £62.1m. The budget reporting throughout the year presented an accurate forecast of the year end financial outturn £60.8m, as indicated in Exhibit 1.

Exhibit 1: 2011/12 budget monitoring



Capital investment and performance - FCS

39. The major capital activities of FCS continue to support the repositioning scheme as outlined in the National forest estate strategic plan 2009-13. The repositioning scheme is focussed on

increasing the parts of the forest estate that have high public benefit. As last year, the market for forest land is still extremely buoyant which has made land acquisitions (£8.0m in total during 2011/12) difficult. Conversely however land disposals are proceeding promptly and achieving good prices on the open market. FES also acquired buildings with a total value of £2.8m during 2011/12.

Capital investment and performance - FES

40. Construction work on the Glentress Peel visitor Centre in the Tweed Valley Forest Park was the main capital construction activity undertaken by FES during 2010/11 and 2011/12. The project was initiated in November 2004 with a £3m budget and target completion date of April 2008. However, the visitor centre construction was moved to a new site in 2005 and a revised business case was prepared with an increased budget of £9m. The visitor centre opened in June 2011 and the total value of the project was £8.5m.

41. The significant change to the project raised concerns and steps have been taken to address weaknesses in project management across the organisation. FES conducted a comprehensive analysis of lessons learned, which formed the basis for a new project management checklist, now incorporated into the ‘FES Project Management Toolkit’.

42. Capital expenditure of £3.1m was also incurred by FES on Vehicles, Machinery and Equipment (VME).

43. Next year (2012/13), FES capital projects include visitor centres' upgrades, for example David Marshall Lodge, Queens View and Galloway visitor centres. A business case for the Mull Pier project, which intends to build a pier on Mull to enable transport of timber from the island, has also been approved.

44. The latest forecast for land acquisitions in 2012/13, reported to the FES Management Board in September 2012, is £7.7m. This is an increase of £1.7m on the original budget, which will be funded from additional disposals income and receipts from timber sales.

Financial planning to support priority setting and cost reductions

2012/13 Budget

45. Scottish Ministers have agreed an initial 2012/13 budget for FCS and FES of £65.5m, of this £38.5m has been dedicated to FCS and £27m to FES. Additional capital funding for "shovel-ready projects" has increased the budget to £66.7m - this includes funding for David Marshall Lodge (£0.7m) and Queen’s View (£0.5m).

46. The latest FCS budget monitoring report from September 2012 shows an increase in FES estimated outturn to £30.5m and a decrease in FCS estimated outturn to 34.8m, forecasting an overall underspend of £1.4m. There may be further changes to the budget as a result of autumn and spring budget revisions.

Workforce management

47. At the end of 2011/12 FCS staff headcount was 138 full time equivalents (FTE), a 6% decrease from 2010/11. FES had 859 FTE at the end of 2011/12, a decrease of 7% compared to the previous year. The decreases in number of staff are mainly due to a recruitment freeze and a Voluntary Early Release (VER) scheme, which resulted in 51 staff leaving FES and FCS at a total cost of £1.5m. A further VER scheme is currently in progress with 10 cases approved for FES.

48. In line with the Scottish Government's policy, FCS and FES continue to operate a policy of no compulsory redundancies and an external recruitment freeze is in place. Outcomes and progress of the VER scheme are discussed regularly at FCS and FES Management Boards meetings. In addition, staffing numbers are monitored by cost centre managers against pre-determined base line figures, however there isn't a specific "workforce plan".

Action Point 3

49. FCS and FES use internal surveys to seek the views of the staff on various aspects of their employment. Survey results have been reported to the FCS Management Board and actions implemented to improve staff satisfaction. Management have indicated that in future the organisations will participate in the civil service-wide survey.

Partnership working

50. FCS and FES continue to play an enabling role in supporting and facilitating partnership working with a variety of partner organisations, including Scotland's environmental and rural services (SEARS). SEARS was established in 2008 and consists of seven other partners involved in the delivery of rural services.

51. As per the results of the FCS and FES best value self-assessment, outlined in paragraph 88,FCS and FES also participate in the Community Planning Partnerships (CPPs) with local authorities and are working closely with urban regeneration companies and other planning and land management bodies. In addition, they continue to explore and promote opportunities for efficiency savings and service improvements through shared service initiatives with partners. For example, FCS shares most core services with the rest of the Forestry Commission whilst Scottish level initiatives include joint working on land management with Scottish Natural Heritage (SNH) and use of SNH’s asset management system.

Outlook

Financial forecasts beyond 2012/13

52. The settlement outlined in the 2011 spending review is the planned budget for 2013/14 and 2014/15 and may still be subject to change. However it provides FCS and FES with a basis for budgeting for the next two years. FCS is planning on the basis of a flat-lined budget (£41.3m for 2013/14 and £41.4m for 2014/15) and FES has been asked to plan for a budget of £22.7m for 2013/14 and £21.7m for 2014/15. This represents cumulative reductions of 15% and 22%

in real terms since 2011/12 (using accepted Treasury deflators at the time of the Scottish Government draft budget of 2.5%, 2.7% and 2.7%).

53. The reduction in funding over the next two years means that savings will need to be found from across the business. Management have also highlighted that there may be other pressures on expenditure and income. These include:

- potential pressures on grant expenditure as levels of demand for grant are likely to continue to rise
- changes in exchange rates and/ or the timber market could impact on income
- pressures on staffing from issues such as plant health and initiatives such as renewables
- a 1% pay rise will require to be incorporated into budgets from 13/14.

54. FCS and FES indicated in their briefing to the Scottish Ministers in September 2011 that they are planning to meet the required expenditure reduction through reduced forestry development programmes, increased EU co-financing income (due to an increase in EU co-financing rate) and staff cost savings for FCS. FES is planning for reductions in administration costs, procurement savings and cuts in recreation, tourism and biodiversity programmes as well as a cut in the capital budget.

Governance and accountability

55. 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.

56. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

57. Consistent with the wider scope of public audit, we have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:

- corporate governance and systems of internal control
- the prevention and detection of fraud and irregularity
- standards of conduct and arrangements for the prevention and detection of corruption

58. In this part of the report we comment on key areas of governance.

Corporate governance

Overall effectiveness

59. The following paragraphs identify areas for improvement in some aspects of the corporate governance and internal control arrangements, but with the exception of these issues we found the overall arrangements to be good.

Processes and committees

60. FCS is directed by the Scottish Ministers through its Board of Commissioners and the National Committee for Scotland (NCS).The NCS is responsible for ensuring that FCS and FES fulfil the aims and objectives set by Scottish Ministers. Its role includes giving strategic direction to all of the Forestry Commission's activities in Scotland, identifying the resources required to meet objectives, ensuring the safeguarding of resources through internal control systems and monitoring financial performance as well as performance targets for the management of Scotland's national forests. Regular corporate and financial information is presented to the committee to allow it to fulfil its role. Committee minutes and papers are available to the public on the FCS website.

61. The Audit and Risk Committee (ARC) is a non-executive sub-committee of the National Committee for Scotland which was established to support the National Committee in its responsibilities for issues of risk, control and governance and assurance. The ARC also

advises the National Committee on the FCS and FES accounting policies and the activity and results of internal and external audit.

62. In September 2010 Audit Scotland published a report on "The role of boards". The report examined the system of accountability within Scottish public bodies and colleges, the public appointments system and the performance of boards in the central government sector. The report included a list of questions for board members to use as a self-assessment tool. During the 2011/12 audit, we undertook follow-up work to assess progress made by FCS and FES against key recommendations in the report.

63. We found that:

- Steps have been taken over recent months to improve the clarity and understanding of information presented to the National Committee for Scotland. The main changes are to the format of the financial monitoring reports and to risk registers.
- Work is on going in several areas to help improve the effectiveness of the National Committee for Scotland. This includes a possible review of how it engages with external stakeholders, a performance assessment of the effectiveness of NCS and implementation of a performance appraisal system for Board members. In addition, a second commissioner has been appointed in July 2012.
- The ARC has recently completed a review of its effectiveness using a self assessment approach. This was presented to the ARC on 20 July 2012 and concluded that no changes are required to the role, remit and meetings of the Committee. A number of actions for improvement were identified in other areas, for example the need to improve members' awareness of legal and regularity issues and to review the process for the ARC ensuring that officials are monitoring action taken to implement external audit recommendations.

Corporate credit cards and government procurement cards

64. Across the public sector government procurement cards have been used to reduce the costs relating to the purchase of small items and some internet based purchases where a credit card is the most effective way of making payment. A recent significant fraud in another public body, which in part resulted from misuse of the government procurement card, highlighted that bodies need to ensure that their processes for the use of these cards are fit for purpose.

65. We therefore undertook a targeted piece of work on use of corporate credit cards and government procurements cards. We made enquiries regarding the use of such payment methods, the number of cards in use and expenditure limits. We also reviewed the controls in place regarding the use of this payment method.

66. FCS and FES spent £3.7m using 1,299 credit cards in 2011/12. The cards were used mainly for travel and accommodation costs, office supplies, and various memberships and subscriptions. We concluded that the overall control environment is satisfactory and this is also subject to regular review by internal audit through the accounts payable and staff expenses testing.

Internal control

67. While we concentrate on significant systems and key controls in support of the opinion on the financial statements, our wider responsibilities require us to consider the financial systems and controls of audited bodies as a whole. The extent of this work is informed by our assessment of risk and the activities of internal audit.

68. As part of our 2011/12 audit, we carried out a review of the main financial systems in FCS and FES, focusing on the key controls in place within each system. Our review covered payroll, the financial ledger, payroll, trade payables, trade receivables, capital accounting, cash and inventories. We reported in our key controls report in May 2012 that whilst overall the systems of internal control are operating effectively, our testing has identified a small number of areas where controls could be strengthened. These included separation of duties between ordering and receiving goods, new starters and leavers documentation and business continuity. We adjusted our financial statements approach to ensure appropriate coverage of these areas and no further issues were identified.

69. We also reviewed the effectiveness of controls operating in FES at a Forest District level by completing audit visits to the Tay and Scottish Lowlands Forest Districts. Testing results were detailed in separate reports issued to FES and FCS management in April 2012.

70. Every year we carry out an assessment of the adequacy of the internal audit function to identify those areas of internal audit work on which we can place reliance. We concluded that the work of internal audit is of a good standard and appropriate reporting procedures are in place. This evaluation allowed us to place reliance on the work of internal audit for the wider scope of our audit work in a number of areas identified in our annual audit plan.

71. The internal audit annual report for 2011/12 concluded that "the control framework within FC and FE Scotland continues to provide substantial assurance that material risks to the achievement of objectives are identified and adequately managed." However, limited assurance opinion was retained for the shared services business continuity and disaster recovery. The report noted that significant progress had been made but the development of an off-site disaster recovery facility and outstanding shared service business continuity plans had not yet been fully implemented.

72. Limited opinion was also outlined in the report for the Forestry Challenge Funds where financial control weaknesses had been identified. In addition, internal audit found a weakness in the authorisation process within shared services for setting up new e-mail accounts and other key business system applications and for access control to FC systems.

73. Internal audit are monitoring progress against their recommendations to address these weaknesses and we will continue to liaise with the internal audit department to confirm progress.

Correspondence

74. The Auditor General for Scotland received seven pieces of correspondence, dated between 30 December 2011 and 17 January 2012, regarding FCS' decision to lease the wind power

potential of the national forest estate. The correspondence highlighted a number of concerns, but the key issue related to the awarding of leases to four foreign owned companies, and the lack of scope for smaller Scottish companies and local communities to be involved.

75. We have investigated the issues raised in the correspondence and outlined our findings in a briefing note which was presented to the Audit and Risk Committee on 9 March 2012.We concluded that the processes followed by FCS were reasonable. The analysis process for selecting the delivery methods appeared robust and FCS could not legally exclude tenders from companies based in other member states of the European Union (EU). There was evidence of FCS incorporating development opportunities for community wind and hydro generation projects, and information on how communities could become involved was available on the FCS website.

Prevention and detection of fraud and irregularities

76. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. We review and report on these arrangements.

77. The overall arrangements for the prevention and detection of fraud are satisfactory. There were no instances of fraud or corruption reported by the FCS and FES in 2011/12.Both organisations have appropriate processes in place to prevent and detect fraud and irregularities, including policies and codes of conduct for staff and members.

78. FCS and FES will participate in the new round of the National Fraud Initiative (NFI), the UK-wide data matching exercise, which matches electronic data within and between participating bodies to prevent and detect fraud. Our report 'The National Fraud Initiative in Scotland', published in May 2012, highlighted that in 2010/11 public bodies recovered 1,681 payments with the total value of £19.8 million. Outcomes of £78 million had been achieved since NFI was first introduced and this represents a significant return to Scotland’s public finances. The report also contained a self-appraisal checklist that all participants are recommended to use prior to the start of the new NFI exercise in October 2012.

Outlook

79. There are many potential governance and structure issues affecting both FCS and FES going forward. The following paragraphs indicate the scale and extent of some of the national changes.

80. The Independent Forestry Panel was established in England in March 2011 to advise the UK government on the future direction of forestry and woodland policy in England. The panel has now completed its work by publishing its final report in July 2012. The report makes it clear that the panel believes the public forest estate is a national asset, which should remain in public ownership. However, the panel recommends an evolution of the Forestry Commission by proposing a new governance structure, with the new organisations having greater financial freedoms. An initial ministerial statement, released by the Department for Environment, Food and Rural Affairs (DEFRA), indicates the UK Government's support for developing a new

model of managing the national forest estate. A full Government's response is expected in January 2013. Management are currently assessing potential implications for FCS and FES.

81. In April 2013 Forestry Commission Wales will become part of the new Welsh environment body, which means that the Forestry Commission will cease to exist as a Great Britain entity. The new body will be formed from a merger of the Environment Agency in Wales, the Countryside Council for Wales and Forestry Commission Wales. The internal audit service will monitor the Wales transition and will have a role in assessing the impact on the rest of the organisation.

82. The Director General of the Forestry Commission has recently announced his intention to retire in 2013. The position of Director General will be replaced with new management and governance arrangements for the Forestry Commission across Great Britain and in England. The central and shared services will be run by a new Director of Central Services.

83. In addition the Director (Scotland), who is the FCS accountable officer, is now also a director of the Scottish Government Environment and Forestry Directorate.

Best Value, use of resources and performance

84. Audited bodies have 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 audited bodies, agree to undertake local work in this area.

85. As part of their statutory responsibilities, the Auditor General may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. We may be requested from time to time to participate in:

- a performance audit which may result in the publication of a national report
- an examination of the implications of a particular topic or performance audit for an audited body at local level
- a review of a body's response to national recommendations.

86. During the course of our audit appointment we also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years. We may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments.

87. This section includes a commentary on the best value and performance management arrangements within the FCS and FES. We also summarise headline performance measures used by the FCS and FES, highlight any relevant national reports and comment on the bodies' responses to these.

Management arrangements

Best Value

88. In March 2011, the Scottish Government issued new guidance for accountable officers on Best Value in Public Services. The new guidance required public bodies to take a systematic approach to self-evaluation and continuous improvement. FCS and FES responded to the guidance by conducting a best value review in March 2012. We have been advised that management intend to perform a self-assessment in each of the seven themes, identified in the guidance, on a rolling basis. However, this proposal has not yet been presented to the Management Boards and is therefore not formally approved.

Action Point 4

Performance management and overview of performance 2011/12

89. FCS and FES operate within a well-established hierarchy of strategic plans. The ten-year Scottish Forestry Strategy, published in 2006, sets out the Scottish Government's framework, vision and priorities for the forestry sector. It details the role of FCS and outlines three outcomes which will together achieve the Scottish forestry vision:

- improved health and well-being of people and their communities
- competitive and innovative businesses contributing to the growth of the Scottish economy
- high quality, robust and adaptable environment.

90. The Scottish Forestry Strategy Implementation Plan 2012-15 sets out actions for the coming year and suggests directions for the following two years to guide the strategy delivery. FCS also produces a corporate plan which lays out the priorities for action. The new corporate plan 2012-15 has recently been finalised and is the current overarching document for FCS and FES. Short guides to the 2012/2013 period of corporate plan have also been prepared, identifying specific FCS and FES priorities.

91. The Scottish Forestry Strategy sets out a commitment to publish annual progress reports. The 2011/12 progress report, published in April 2012, summarises achievements against the three strategy outcomes. Of the 200 actions in the 2011-2012 Implementation Plan, 186 (93%) were achieved and 13 (7%) were carried over to 2012/13.

92. FES is currently preparing a new Strategic Directions document which will replace the current National Forest Estate Strategic Plan 2009-13, setting out the framework for spatial planning on the national forest estate. The current strategic plan directs implementation of the Scottish Forestry Strategy on the national forest estate over the five years from 2009 to 2013. It provides context and directions for ten local Forest District Strategic Plans, which define how the strategic plan is implemented at a local level and account for local priorities and context.

93. The National Committee for Scotland set 11 Key Agency Targets for FES to achieve in 2011/12. FES achieved or exceeded 9out of 11 targets. These include:

- 100% of the national forest estate independently certified as being sustainably managed - as last year, this target has been 100% achieved
- 1,012 hectares of woodland creation - 1,121 hectares achieved
- 100% of sales plan harvested - 102.3% achieved
- 3% annual reduction in carbon emissions from offices – 8% achieved.
- The two targets not achieved were:
- 91% satisfaction with woodland recreation provision - 90.3% achieved
- Total unit cost of direct timber production to roadside of £12 - £12.26 achieved.

Community engagement

94. FCS and FES recognise the importance of community engagement by allowing appropriate consultation and input from key stakeholders in decision making processes. Extensive consultations are used in preparation of key documents, such as new strategies. Examples include the public consultation on the draft "Strategic Directions for National Forest Estate 2012-2015", which outlines how FCS and FES propose to manage the national forest estate over the next three years, and also the establishment of five Regional Forestry Forums (replacing the Regional Advisory Committees) to advise on forestry policy and practice in their areas. One of the many roles of the forums is to advise on regional implementation of the Scottish Forestry Strategy and provide a regional perspective on the strategy's future development.

95. A 2006 study commissioned by FCS, Community Woodlands Association and Highlands & Islands Enterprise, examined partnerships between community groups and FCS and reported very positive results regarding the value and operation of partnerships. The findings were updated in the March 2010 report, which outlined a general positive view from community groups working in partnership with FCS, although with some concerns over future resource allocation and the level and effectiveness of communications.

96. The Woodland Expansion Advisory Group is another example of community engagement. It consists of farmers, forestry, conservation, community and land experts who work to help identify which types of land are best suited for tree planting in Scotland. A key work area for the group is to ensure that all those groups with an interest have an opportunity to be consulted. The group first met in August 2011 and published its final report in June 2012. The Cabinet Secretary for Rural Affairs and Environment has made his response, accepting all recommendations.

97. There are further examples of effective community engagement, such as engagement with the Association of Deer Management Groups. In addition, each regional team has a dedicated community and local engagement capacity. A new Facebook site was also set up earlier this year to improve the promotion and uptake of the recreation offer on the national forest estate.

National performance reports

98. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest are detailed in the Exhibit below.

Exhibit: A selection of National performance reports 2011/12

- Scotland's Public Finances - addressing the challenges (Aug 2011)
- The National Fraud Initiative in Scotland (May 2012) - outlined in paragraph 78
- Reducing Scottish greenhouse gas emissions (December 2011)

Source: www.audit-scotland.gov.uk

Scotland's Public Finances - addressing the challenges

99. The report highlighted that all parts of the public sector had less to spend in 2011/12 than in 2010/11 even though the level of budget reduction varied significantly, with central government funding experiencing the biggest reduction of 12 per cent. Although most bodies were able to agree a balanced budget for 2011/12 the report outlined the risk that savings may not be realised and that unforeseen pressures may emerge which will reduce the ability to generate future savings. The report also emphasised the importance of long-term financial sustainability when looking to reduce costs, including consideration of key areas such as reducing workforce levels and identifying opportunities to share services.

100. As already mentioned in paragraph 33, the Scottish Government provides FCS and FES with a budget allocation for the year, which originates from the Spending Review Settlement. We also already reported in paragraph 37, the budget setting and monitoring arrangements in FCS and FES are sound therefore the organisations should be well placed to ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers.

Reducing Scottish greenhouse gas emissions

101. The report stated that overall Scottish emissions have reduced by more than a quarter since 1990. However, they must continue to fall at a similar rate between 2009 and 2020 to meet statutory targets. Around a third of planned emissions reductions are expected to come from policies solely under the Scottish Government's control and FCS and FES have a visible role to play in this. One of the Scottish Government's proposals, outlined in the report, was an increase in the afforestation rate to 15,000 hectares per year from 2012 onwards to support the target to increase woodland cover to 25 per cent of Scotland. As per the Scottish Government report on proposals and policies "Low Carbon Scotland: Meeting the Emissions Reduction Targets 2010-2022" (March 2011), this proposal was made subject to establishing that such a goal would be practicable and cost effective.

102. However, the Woodland Expansion Advisory Group (see paragraph 96) recommended in its report, published in June 2012, that the afforestation rate should not be increased to 15,000 hectares as per the Scottish Government's proposal. The Group's recommendation was that the focus should be on increasing the afforestation rate to 100,000 hectares in ten years (i.e. 10,000 hectares per year) rather than on increasing the woodland cover to 25 per cent of Scotland. The Scottish Government accepted the Group's recommendations and the cost of this policy up to the end of 2020 in current prices (using a discount rate of 3.5%) has been estimated at £375m.

Arrangements to consider national performance reports

103. There is no systematic approach in place to ensure that relevant reports are considered by management and the Audit and Risk Committee. Management have advised us that relevant reports have been considered in 2011/12 and that related processes will be further updated for 2012/13.

Action Point 5

Appendix A: audit reports

External audit reports and audit opinions issued for 2011/12

Title of report or opinion	Date of issue	Date presented to Audit Committee
Briefing note on complaints investigation - wind power leases of national forest estate	9 February 2012	9 March 2012
Annual Audit Plan	22 February 2012	9 March 2012
Key Controls Report	8 May 2012	Not presented
Report on financial statements to those charged with governance (ISA 260 report)	13 July 2012	20 July 2012
Audit opinion on the 2011/12 financial statements	13 July 2012	20 July 2012
Summary matters arising	10 August 2012	Not presented - for use by management

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	25	**Valuation of timber inventories and work-in-progress** As in previous years, the total valuation of felled timber at roadside and at stump is based on a Forest District (FD) average "unit price" for “standing sales clear fell” sale category. There is a risk that this method of valuation does not accurately reflect the value of timber inventories and work-in-progress because it relates to the price of uncut timber.	An accurate valuation of 2012/13 timber inventories will be provided and incorporated in period nine interim financial statements. In particular, information on timber inventories will be collated on a contract basis, which will enable the analysis of inventories by product type and relevant unit price.	FES Head of Finance	31 January 2013
2	29	**Change in accounting for the national forest estate** Senior management reconsidered the accounting for national forest estate and decided to transfer it from FCS to FES during 2012/13. There is a risk that this significant change in accounting policy will result in major changes to 2012/13 FCS and FES accounts, including restated comparatives. This major change may impact adversely on the accounts preparation process or on the high quality of accounts submitted for audit.	We will develop a plan for revising our 2012/13 financial statements to include the required changes and prepare revised comparator information for 2011/12 early in this process.	FCS and FES Heads of Finance	31 March 2013

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
3	48	**Workforce planning** Workforce plans are not in place in FCS or FES. Whilst staff numbers appear to be adequately managed, there is a risk that the factors and impacts of a significant change in staffing levels are not fully considered and planned for. This might include actions to deal with skills and experience gaps or planned changes in activity/ services provided.	Workforce plans will be prepared for 2013/14.	Head of Corporate Services	31 March 2013
4	88	**Best Value** In March 2011, the Scottish Government guidance required public bodies to take a systematic approach to self-evaluation and continuous improvement. FCS and FES responded to the guidance by conducting a comprehensive best value review in March 2012, but have not yet agreed an approach to future best value reviews. There is a risk that FCS and FES are unable to demonstrate best value.	Officers propose that a self-assessment against each of the seven themes identified in the guidance will be performed on a rolling basis. However, this has not yet been presented to the Management Boards and is therefore not formally approved. The response will be presented to the Management Board meetings in October 2012.	Head of Corporate Services	31 December 2012
5	103	**Arrangements to consider Audit Scotland national performance reports** Although all relevant reports have been considered in 2012/13, there is no systematic approach in place to ensure that	FCS Management Board will put in place arrangements for consideration of Audit Scotland national performance reports and assessment of	Head of Corporate Services	31 March 2013

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		reports are considered by management and the Audit and Risk Committee. There is a risk that key issues and recommendations in national reports are not considered by FCS and FES.	implications for FCS and FES.		