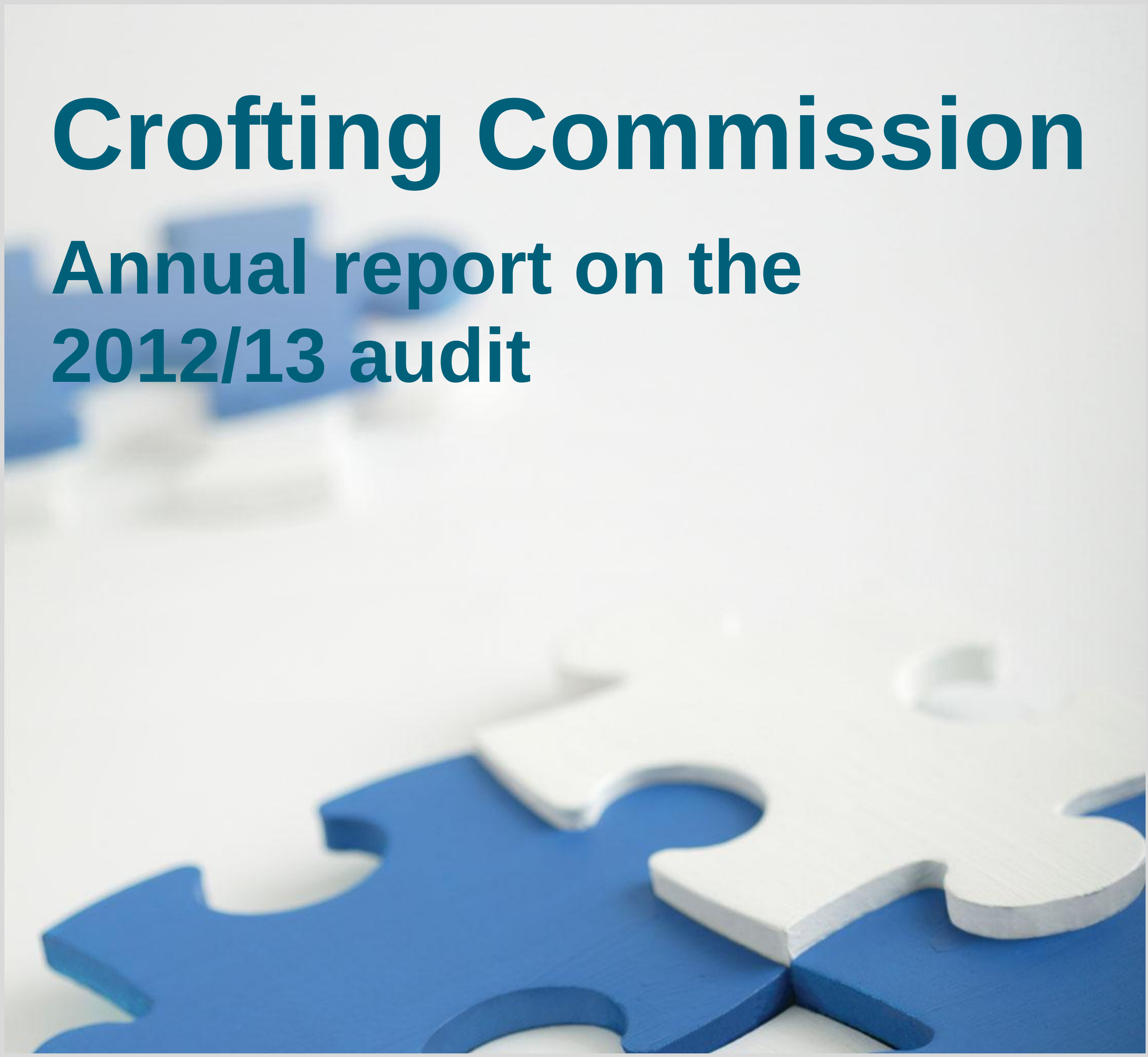
Crofting Commission

Annual report on the 2012/13 audit



AUDIT SCOTLAND

Prepared for Members of the Crofting Commission and the Auditor General for Scotland
October 2013

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

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Key Messages

2012/13

We have given an unqualified opinion that the Crofting Commission's ("the Commission") 2012/13 financial statements give a true and fair view of the state of the body's affairs and of its net expenditure for the year.

As expected in this first year of the Commission, a number of presentational and monetary adjustments were identified during our audit. We are satisfied that a number of these items have been resolved and therefore there will be a smaller level of adjustment in future years.

The Commission exceeded its total Grant in Aid budget by £46,000, although it operated within its Resource Departmental Expenditure Limit ("DEL"). This occurred as a result of our audit findings, which required several non-cash adjustments. The Commission has obtained approval for this overspend.

The 2012/13 budget was not approved until November 2012 as Commissioners were not appointed until after the start of the financial year. Similarly, the 2013/14 budget was not approved until April 2013. Work is on-going to develop a process to ensure that the 2014/15 budget is approved before the start of the financial year.

As a result of legislation, the Commission's Convener is the Chair of the Board and Audit & Finance Committee, contrary to good practice. However, in practice, the Convener does not attend the Audit & Finance Committee meetings, which are chaired by another Commissioner.

The Commission had appropriate governance arrangements in place which included the Audit & Finance Committee overseeing key aspects of governance. Overall the Commission's arrangements for the prevention and detection of fraud were satisfactory during 2012/13.

Outlook

We confirm the financial sustainability of the Commission on the basis of its financial position and projected financial summary. The financial position going forward is however becoming more challenging with spending constraints coupled with increasing cost pressures. This represents a major challenge for the Commission and expenditure during the year will require to be closely monitored to identify and address any emerging budget pressures or projected overspends at an early stage. The significant financial challenges will make maintaining or improving on the performance targets set by the Scottish Government even more challenging.

As this was the first year of the Commission, specific work was required by Management for Corporate Governance. Since her appointment, the Chief Executive has implemented a number of improvements including changing the Commission's management structure and reviewing and updating policies and procedures.

Introduction

1. This report is the summary of our findings arising from the 2012/13 audit of the Commission. The purpose of the report is to set out concisely the scope, nature and extent of the audit. It summarises our opinions (i.e. on the financial statements) and conclusions on significant issues arising.

2. The report also reflects our overall responsibility to carry out an audit in accordance with the public sector audit model which is based on the Code of Audit Practice prepared by Audit Scotland (May 2011). This sets out the wider dimensions of the public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements prepared by management. However, this does not relieve management of their responsibilities in this respect. This report has been prepared for the use of the Commission and no responsibility to any third party is accepted.

3. Appendix A is an action plan setting out the high level risks we have identified from the audit. 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 the Commission understands its risks and has arrangements in place to manage these risks. Commissioners should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.

4. This report is also addressed to the Auditor General for Scotland and will be published on our website after consideration by the Commission's Audit & Finance Committee and after the financial statements have been laid before Parliament.

Financial statements

Conduct and scope of the audit

5. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Audit & Finance Committee on 23 January 2013, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.

6. As part of the requirement to provide full and fair disclosure of matters relating to our independence we can confirm that we have not undertaken any non-audit related services. The 2012/13 agreed fee for the audit was disclosed in our Annual Audit Plan. During this formative year of the Commission as a Non-departmental Public Body ("NDPB") we have undertaken additional unplanned audit work, but we have agreed to absorb this work within the existing fee.

Audit opinion & accounting issues

7. We have given an unqualified opinion that the financial statements of the Commission for 2012/13 give a true and fair view of the state of the body's affairs and of its net expenditure for the year. The audit opinion was formally issued and signed on 7 August 2013.

8. We received the unaudited financial statements on 3 June 2013 in accordance with the agreed timetable. The working papers were of a high standard and staff provided good support to the audit team. We completed our on-site fieldwork on Friday 7 June 2013, although further audit work was undertaken off-site during the following weeks.

9. The unaudited annual report and financial statements consisted of several different documents. We have agreed with management that in 2013/14, we will receive the combined annual report and accounts in one single document at the start of the audit.

Refer to Action Plan 1

10. The Commission is required to follow the Government Financial Reporting Manual ("FReM") and we can confirm that the financial statements have been properly prepared in accordance with these accounting requirements.

Significant findings (ISA260)

11. As expected in this first year of the Commission, a number of presentational and monetary errors were identified during the course of our audit, which were adjusted in the audited accounts. We are satisfied that a number of these items primarily arose because this was the Commission's first year of producing FReM compliant accounts. Therefore, we expect that there will be a smaller level of adjustment in future years.

12. During the course of the audit we identified a number of significant issues regarding un-capitalised expenditure, the timing of transactions and accruals for untaken employee leave.

11/12 ICT Hardware Adjustments

13. The largest adjustment to the accounts related to a number of 2011/12 IT hardware and software purchases, which had not been capitalised. An adjustment was made to the accounts to recognise these assets and to charge depreciation and amortisation accordingly.

Annual Leave and Flexi Accruals

14. The year-end annual leave and flexi accruals were not included in the first version of the draft accounts. These totalled £46,000 and were required for the cost of carrying forward unused leave and flexitime into the new financial year (2013/14). An adjustment was subsequently made to the accounts to recognise this accrual.

Written Assurances

15. We advised the Head of Finance that additional written assurances should be sought by the Accountable Officer for the Governance Statement as follows:
    - Assurances from the Scottish Government ("SG") regarding the HR and Payroll systems, which it provides.
    - Assurances from Scottish Natural Heritage ("SNH") regarding the Oracle financial ledger, which it manages.
    - Assurances from the Commission's Senior Management Team to ascertain whether there were any internal control weaknesses during the financial year.

Refer to Action Plan 2

Financial position

2012/13 Outturn

16. The main financial objective for the Commission is to ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers. Table 1 shows the initial and final budgets for the year. The increase in the Commission's budget arose because the SG provided an additional £100,000 funding for the Grazings Project.

17. The Commission exceeded its total Grant in Aid budget by £46,000. This was as a result of our audit findings, which required several non-cash adjustments for depreciation (£16,000), amortisation (£75,000) and the annual leave and flexi accruals (£46,000).

18. The Commission also exceeded its capital DEL. During the audit, we found that the Commission had purchased an intangible asset, which had been incorrectly recorded as revenue expenditure rather than capital expenditure. Therefore, an adjustment of £6,000 was required to recognise this item, resulting in a £2,000 overspend within the capital budget.

19. We are satisfied that the Commission has operated within its Resource DEL budget, and overspends within the capital and non-cash budgets were as a result of non-cash adjustments following our audit findings. The Commission has obtained approval for this overspend from its Sponsor Branch.

Table 1: Resource Budget

	Initial Budget (£'000)	Final Budget (£'000)	Actual Outturn (£'000)	Under / (Over) spend
Resource DEL	£2,445,000	£2,545,000	£2,494,000	£51,000
Capital DEL	£4,000	£4,000	£6,000	(£2,000)
Non Cash DEL	£42,000	£42,000	£137,000	(£95,000)
Total	£2,491,000	£2,591,000	£2,637,000	(£46,000)

Source: Crofting Commission Annual Report and Accounts 2012/13 and SG's 2012/13 Grant in Aid Letter to the Commission

2012/13 Financial position

20. The Statement of Financial Position reports closing net assets of £104,000. As this is the first year of the Commission's existence as an NDPB, there is no meaningful prior-year comparator for this figure, although we are satisfied that this is indicative of a sound financial position.

21. Although there is clear evidence of the budget being managed within the overall funding allocation (involving the use of virement), we noted that there were several lines in the initial budget that were exceeded in 2012/13, including professional services. This arose as a result of the Commission's decision to appoint a panel of solicitors rather than to employ an in-house solicitor. The panel is instructed to represent the Commission in actions brought against it in its role as regulator and for ad-hoc legal advice.

22. We understand that the Commission anticipates a similar overspend in 2013/14. Whilst we recognise that the number of claims brought against the Commission is outwith its control and that this is the Commission's first year of existence, we would reinforce the importance of the Commission managing legal and other expenditure within its budgets, particularly given spending constraints within the wider public sector.

Refer to Action Plan 3

Financial planning

23. The Commissioners were not appointed until after the start of the financial year. Therefore, the 2012/13 budget was not approved until November 2012. The Board approved a budget for 2013/14 in April 2013 pending completion of a fuller business planning process. We understand that the development of that business planning process is currently on-going and will be discussed at the November meeting of the Audit & Finance Committee. It is expected that a full process cycle will be in place enabling approval of the 2014/15 budget in accordance with the process before the start of the financial year.

24. Following the announcement of the draft Scottish Budget issued in September 2013, the Commission's budget will remain constant at £2.6 million up to and including 2015/16, which is broadly in line with the Commission's 2012/13 budget. In 2011/12, the Sponsor Branch advised the Commission of its intent to provide level pre-inflation funding for the first 3 years of its existence i.e. to end 2014/15. As a result, the Commission is required to absorb annual pay increases and other inflationary elements by offsetting against other cost reductions. Discussions over resource requirements are underway with the Sponsor Branch. It is important that Management and the Board continue to monitor this to ensure that the Commission operates within its budget.

Refer to Action Plan 4

Corporate governance and systems of internal control

The Board and Audit & Finance Committee

25. The Crofting Reform (Scotland) Act 2010 states that the Convener of the Commission is the Chair of the Board and all other committees of the Commission, including the Audit & Finance Committee. This is contrary to good practice and SG guidance.

26. However, in practice, the Convener does not attend Audit & Finance Committee meetings, which are chaired by another Commissioner. We consider that this is a pragmatic solution to this issue, given that it is unlikely that the Scottish Parliament will legislate to correct this anomaly in the near future.

27. In September 2013, one of the Commissioners, Donnie Ross, resigned. We understand that the Commission is currently in discussions with the Sponsor Branch to determine how this Commissioner will be replaced. We will monitor this situation.

Accounting and internal control systems

28. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.

29. The Commission relies on the SG's HR and Payroll services. Further, SNH provides the Commission's financial ledger. Audit Scotland undertakes the external audit of the SG and SNH.

30. No material weaknesses in the accounting and internal control systems were identified during the audit of either the Commission, the SG or SNH, which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

31. During 2012/13, the Commission had a number of management changes. In December 2013, Nick Reiter retired as Chief Executive and was replaced by David Balharry on a temporary

basis. In May 2013, the Commission appointed Catriona MacLean as its permanent Chief Executive.

32. The Commission has employed staff on temporary contracts for some time within the Finance Team, particularly for the role of Finance Team Manager. We have been advised that a permanent appointment has been made to the Finance Team Manager post, starting 1st December.

33. Internal Audit is an important element of the Commission's governance structure. Scott Moncrieff were appointed as Internal Auditors towards the end of the 2012/13 financial year. Ordinarily, we would seek to liaise with Internal Audit to avoid duplication of work. However, that was not possible in 2012/13 due to the late appointment of Scott Moncrieff. We will work more closely with Scott Moncrieff in the coming financial year.

Policies and Procedures

34. As this was the first year of the Commission as an NDPB, we appreciate that work has been on-going to develop a number of policies.

35. In our Annual Audit Plan, we noted that the Commission's 5-year Plan and its Management Statement/Financial Memorandum ("MSFM") were awaiting approval from the Scottish Ministers. These approvals have now been granted. We note that the Commission has yet to adopt a workforce plan, although discussions are taking place with the Sponsor Branch.

36. Since her appointment, the Chief Executive has been proactive in addressing a number of issues within the Commission, including:

- Establishing the Senior Management Team (Heads of Regulation, Finance & Governance, Communications, Information Systems, Policy & Duties and a temporary Business Manager).
- Updating the Commission's standing orders and reviewing all business processes to identify and prioritise risk.
- Undertaking a review of complaints, policy and procedures, appeal cases and governance, all with Commissioner involvement.
- Introducing a revised meeting structure, including reviews of agendas, papers and minutes to make meetings more open, accessible and compliant with all relevant legislation.
- Implementing a resourcing plan, a corporate year planner and a training plan.

We will monitor these improvements over the course of our audit appointment.

37. The Commission is based in Great Glen House, which it shares with the building's owners, SNH. A Memorandum of Terms of Understanding ("MOTU") is in place; however a subsequent amendment to the MOTU has been agreed, but not signed. This has been delayed pending discussion with SNH of additional clauses to mitigate the risk of unexpected additional costs.

Refer to Action Plan 5

Overall governance arrangements

38. The Code of Audit Practice gives auditors a responsibility to review and report on audited bodies' corporate governance arrangements and overall we found the Commission had appropriate governance arrangements in place which included the Audit & Finance Committee overseeing key aspects of governance. These arrangements appear appropriate for the Commission.

Prevention and detection of fraud and irregularity

39. In our Annual Audit Plan we highlighted the responsibility audited bodies have for establishing arrangements to prevent and detect fraud and other irregularities. In our opinion the Commission's overall arrangements for the prevention of fraud are satisfactory, although it should be noted that no system can eliminate the risk of fraud entirely. We have been informed that there have been no frauds identified at the Commission during 2012/13.

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

40. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place. No issues have been identified by us for inclusion in this report.

Best Value

41. Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily. 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 the Commission, agree to undertake local work in this area.

42. In March 2011, the SG issued new guidance for accountable officers on Best Value in Public Services. The new guidance, in essence, required public bodies to take a systematic approach to self-evaluation and continuous improvement. The Commission's MSFM places a duty on the Accountable Officer to secure Best Value. The MSFM also places an obligation on the Board to ensure that the Commission fulfils the aims and objectives set by the Scottish Ministers and promotes the efficient and effective use of staff and other resources by the Commission in accordance with the principles of Best Value.

43. The issue of Best Value was discussed at the Audit & Finance committee on 7 May 2013. The committee agreed that the MSFM requires the Commission to adhere to Best Value Principles, but that the Commission would not implement a separate plan.

44. We recognise that the Commission needs to be proportionate in its approach to implementing Best Value. However, the Commission has not formally considered the guidance or performed a self-assessment.

Refer to Action Plan 6

National Reports

45. Over the past few months, Audit Scotland has published a number of national reports, which are relevant to the Commission as follows:

Renewable Energy (published September 2013)

46. The report looks at public sector action and investment in developing renewable energy and what has been delivered to date. The SG has a clear strategy for renewable energy that links with other policy areas, and it has made steady progress so far. Achieving its overall goals will be challenging and depends on private sector investment. The SG wants Scotland to be a world leader in renewable energy and for renewable sources to meet 30 per cent of the country's total energy consumption by 2020.

47. The report focuses on the SG, Scottish Enterprise, and Highlands and Islands Enterprise. Its findings include:

- Scotland is making steady progress towards meeting its renewable energy targets for 2020, but achieving them will be challenging.
- The public sector has spent over £209 million since 2002 on developing renewable energy.
- Funding will rise sharply over the next two years, with a total budget of £264 million available.
- Renewable energy projects are progressing more slowly than expected, due to the economy and changes in UK energy policy. As a result, public bodies have experienced delays in spending some of the money available for initiating and supporting projects.
- The SG expects renewable energy to deliver up to £30 billion investment and 40,000 jobs. It needs to improve its recording of private sector investment and work with other public bodies to develop more realistic employment projections.

Developing Financial Reporting in Scotland (published July 2013)

48. The report highlights why good financial reporting matters. Reporting of Scottish finances will need to develop further in light of new powers. The SG will need to make sure its financial reporting is more comprehensive and transparent as it prepares for new tax and borrowing powers. It is a contribution to preparations for new financial powers as the Scotland Act 2012 is implemented over the next three years.

49. The report says that while the audited accounts of public bodies across Scotland provide a sound base for financial reporting and scrutiny, there is currently no single complete picture of the devolved public sector's finances, and particularly its assets and liabilities. The SG will

need to further develop its public financial reporting ahead of the new powers taking effect, making sure it is comprehensive and transparent. Areas of particular consideration include:

- The long-term consequences of funding assets from borrowing or public private partnerships.
- How forecasts and other estimates are made.
- How potential liabilities are assessed and monitored.
- The clarification of complex accounting issues.

Managing Early Departures from the Scottish Public Sector (published May 2013)

50. The report is designed to help public bodies improve their management and reporting of early release schemes. Scotland's public bodies need to demonstrate the value for money from schemes allowing staff to take early retirements and redundancies. The report says such schemes can provide significant savings, and public bodies generally follow good practice. But there are striking differences between the schemes and a marked inconsistency in how public bodies report the costs and expected savings. Almost 14,000 employees took such packages between 2010 and 2012 - around one in forty of all public sector staff. While the cost of these amounts to more than £550 million, organisations generally expect to make savings from their action over a number of years.

51. The report prepared for the Accounts Commission and the Auditor General, gives pointers on good practice, including:

- Demonstrating that schemes are value for money.
- Making sure schemes are clear, well-designed and meet business needs.
- Reporting openly on the costs and savings.
- Ensuring good scrutiny over schemes and particularly of exit packages for senior executives.

Acknowledgements

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

Appendix A: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Issues Identified	Planned Management Action	Responsible Officer	Target Date
1	9	Management provided several different documents comprising the 2012/13 Annual Report & Accounts.	In 2013/14, Management will provide a combined copy of the annual report and accounts in a single document at the start of the financial statements audit.	Head of Finance	Summer 2014
2	15	Additional assurances are required for the Governance Statement.	The Chief Executive will obtain the following assurances for 2013/14 • from the SG regarding the HR and Payroll system, which it provides. • from SNH regarding the Oracle financial ledger, which it manages. • from the Commission's Senior Management Team to ascertain whether there have been any weaknesses in internal control during the financial year.	Chief Executive	30/04/14
3	22	The Commission overspent its legal budget in 2012/13 and anticipates a similar overspend in 2013/14. Whilst legal costs may be outwith the Commission's control and that this is the Commission's first year of existence, we would reinforce the importance of	The Commission operates a flexible budget arrangement with delegated powers of virement and ongoing monitoring of actual and forecast spending. This enables adjustment of in-year spending over a range of budget heads to ensure overall spending remains within budget. In 2012/13	Chief Executive	31/03/14

Action Point	Refer Para No	Issues Identified	Planned Management Action	Responsible Officer	Target Date
		the Commission managing legal and other expenditure within its budgets, particularly given spending constraints within the wider public sector.	this was applied to take into account the anticipated legal overspend. Similar oversight is being applied in 2013/14. For the future, the Commission and its predecessor body now have experience of each of: an in-house solicitor; retained legal services provided by a 3rd party; and services from a panel of external solicitors. A review will be conducted by the end of this financial year to consider future provision.		
4	24	The Board approved the Budget late in the financial year. It is important that Management and the Board continue to monitor this to ensure that the Commission operates within its budget.	The development of a business planning process is currently on-going and will be discussed at the November meeting of the Audit & Finance Committee. A full process cycle will be in place enabling approval of the 2014/15 budget in accordance with the process before the start of 2014/15.	Chief Executive & Board	28/02/14
5	37	The Commission has not signed an amendment to its MOTU with the owners of its offices, SNH.	A Memorandum of Terms of Understanding was signed on 13th December 2010. An amended MOTU was presented to the Commission by SNH in autumn 2012. This has not yet been signed pending discussion with SNH of additional clause(s) to	Chief Executive, Audit & Finance Committee	05/11/13

Action Point	Refer Para No	Issues Identified	Planned Management Action	Responsible Officer	Target Date
			mitigate risk of unexpected additional costs.		
6	44	In March 2011, the SG issued new guidance for accountable officers on Best Value in Public Services, which required public bodies to take a systematic approach to self-evaluation and continuous improvement. However, the Commission has not formally performed a self-assessment.	Management accepts that a self-assessment possibly conducted by or with the assistance of internal audit, could be useful and informative. Previous advice suggests it should focus on the extent to which current or proposed structure and policy are in accordance with Best Value principles, and should be proportional to the size of organisation.	Head of Finance	31/03/14