Crofting Commission

Annual Report on the 2013/14 audit

Prepared for the Crofting Commission and the Auditor General for Scotland

7 August 2014

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

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Key Messages

2013/14

We have given an unqualified opinion that the financial statements of the Crofting Commission ("the Commission") for 2013/14 give a true and fair view of the state of the body's affairs and of its net expenditure for the year.

The Commission exceeded its Resource Departmental Expenditure Limit ("DEL") by £20,000 and its depreciation/amortisation budget by £18,000 on an accruals basis. However, the Commission operated within its cash budget for 2013/14 and obtained approval from its Sponsor Branch at the Scottish Government for the £38,000 overspend on an accruals basis.

The Commission has not prepared its own Fraud Policy, but has adopted the Scottish Public Finance Manual ("SPFM"). The Commission should develop its own detailed Fraud Policy as required by the SPFM.

Tangible assets are not tagged and do not have unique reference numbers assigned to them in the asset register. Therefore, management cannot easily identify its assets and verify the completeness of the asset register.

The Commission had appropriate governance arrangements in place, which included the Audit and Finance Committee overseeing key aspects of governance. The Corporate Plan 2014/17 was approved in March 2014. Work is ongoing to develop a Business Plan to implement the Corporate Plan.

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 than previous years with limited increases in funding coupled with increasing cost pressures. We note that the Scottish Government has given the Commission permission to overspend its Grant in Aid budget by up to £310,000 per annum over the next three years, as a result of additional requirements introduced under the Crofting Reform (Scotland) Act 2010. Funding pressures and the additional requirements of the 2010 Act represent 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 difficult.

Introduction

1. This report is the summary of our findings arising from the 2013/14 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 1 sets out the key audit risks identified at the planning stage of the audit and details how we addressed each risk in arriving at our opinion on the financial statements.

4. Appendix 2 is an action plan setting out the high level risks we have identified from the audit. Officers 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. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.

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

6. The Commission's management is 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 audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Financial Statements

Conduct and scope of the audit

7. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in the Annual Audit Plan presented to the Audit and Finance Committee on Monday 10 February 2014, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.

8. As part of the requirement to provide full and fair disclosure of matters relating to our independence we can confirm that we have not undertaken non-audit related services. The agreed fee for the 2013/14 audit was £14,480 (2012/13 £14,480) and as we did not require to carry out any additional work outwith our planned audit activity this fee remains unchanged.

Audit opinion & accounting issues

9. We have given an unqualified opinion that the financial statements of the Commission for 2013/14 give a true and fair view of the state of the body's affairs and of its net expenditure for the year. The audit opinion was formally issued and signed on 6 August 2014.

10. We received the unaudited financial statements on Monday 2 June 2014 in accordance with the agreed timetable. We are pleased to report that we received a substantially complete annual report and accounts in one single document, which is an improvement on the position reported last year. The working papers were of a good standard and the staff provided support to the audit team. We completed our on-site fieldwork on Friday 13 June 2014.

11. The Crofting Commission is required to follow the 2013/14 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 and key judgements (ISA260 Report)

12. A number of the presentational and monetary errors that we identified during the 2012/13 audit have been rectified. However, during the course of the audit we identified a number of significant issues relating the Commission's treatment of tangible and intangible non-current assets, an accrual that was made in error and a contingent liability for potential legal costs.

Prior-year additions

13. Two of the assets sampled (totalling £6,687) were purchased in 2012/13, but were not capitalised until 2013/14. As a result, 2012/13 asset additions were understated by £6,687 and 2013/14 asset additions were overstated by £6,687.

14. Management decided not to make an adjustment to the financial statements in respect of this error. This error is below our materiality threshold of £25,000 and therefore we are satisfied with the approach taken by management.

15. In addition, depreciation and amortisation was not charged on these in 2012/13 however the value of this error is insignificant (below £1,000) as these were purchased towards the end of 2012/13.

Asset Register Completeness

16. The Commission's assets do not have unique reference labels and are not easily identifiable in the Commission's asset register. In addition, several of the assets have been grouped and included as one entry in the asset register. As a result, we were unable to identify on the asset register one of the three assets we sample tested to verify the completeness of the asset register.

17. We discussed this with the Head of Finance and the IT Officer, who agreed to tag each asset with a unique reference number and ensure that all assets were identified individually on the asset register, with the unique reference number.

Refer to action point 1

Capitalisation of Revenue Expenditure

18. During our testing of capital additions, we identified that revenue expenditure for repairs and maintenance was capitalised in four of the eleven invoices sampled. The total amount of this error was £4,110. An adjustment was made to recognise this as revenue expenditure.

Accrual

19. We identified one invoice accrual that related to two training days that took place in March and April 2014. The training day in April 2014 cost £1,118 but related to 2014/15 and therefore should not have been accrued. An adjustment was made to recognise this in the correct financial year.

Contingent Liability - Potential Legal Costs

20. The Commission is required to defend appeals against its decisions in the Land Court, with the potential that if the Commission is unsuccessful, the Land Court may instruct the Commission to pay the pursuers' costs. A number of claims are ongoing. We determined that this should be disclosed as a contingent liability in the accounts under IAS 37 and this was adjusted accordingly by management. This should be disclosed as a contingent liability rather than a provision because it is possible, but not probable, that the Commission may have a liability in respect of these legal costs.

Financial position

2013/14 Outturn

21. 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.

22. In our 2012/13 Annual Audit Report and 2013/14 Annual Audit Plan, we noted the risk that overspends within individual budgets could result in the Commission overspending its Resource Departmental Expenditure Limit ("Resource DEL").

23. The Crofting Commission overspent its Resource DEL for 2013/14 on an accruals basis by £20,000 and overspent its amortisation budget by £18,000 as detailed in Table 1 below which also shows the budget changes that occurred during the financial year. The resource overspend was 1.5% of total budget. However, the Commission operated within its cash budget for the year. The Commission obtained approval from the Scottish Government Sponsor Branch for this overspend.

Refer to action point 2

Table 1: Resource Budget

	Initial Budget (£'000)	Final Budget (£'000)	Actual Outturn (£'000)	Under / (Over) spend
Resource DEL	2,547	2,384	2,404	(20)
Capital DEL	0	163	163	0
Total	2,547	2,547	2,567	(20)
Non Cash DEL	63	63	81	(18)
AME	0	0	0	0

Source: Grant in Aid Letter and the Commission's 2013/14 Accounts

24. During 2013/14, management considered that there was a risk that it would underspend its Resource DEL and therefore received permission from the Scottish Government to transfer up to £170,000 from its revenue budget to its capital budget. The Commission subsequently spent £163,000 on capital additions required for the Crofting Information System and various other IT projects, which appears to have contributed to the Commission's Resource DEL overspend.

25. Similar to last year, the Commission overspent its legal budget by £16,000.

26. In 2013/14, the Commission changed its amortisation policy to amortise all intangible assets over a three year useful life, whereas previously some intangible assets were amortised over five years, increasing the amortisation cost in 2013/14. We are satisfied that the depreciation/amortisation overspend occurred as due to the increased IT expenditure during the year and the change to the Commission's accounting policy.

2013/14 Financial position

27. The Commission's total resource expenditure in 2013/14 was £2.485 million (2012/13 £2.631 million). The most significant item of expenditure was for Board Members and Staff Costs,

totalling £1.766 million (2013/14 £1.807 million). Other significant items of expenditure include accommodation costs of £0.174 million and IT expenditure of £0.114 million.

28. The Statement of Financial Position reports closing net assets of £162,000, compared to the 2012/13 reported £104,000 net assets. Despite the Commission's overspend, we are satisfied that this is indicative of a sound financial position.

29. In Note 11 to the Accounts, the liabilities include £40,000 of "Other Liabilities". This is a result of the Commission holding cheques and cash on behalf of the Registers of Scotland ("RoS"), whilst the Commission processes crofters' applications to RoS's Crofting Register. Once the Commission has processed the application, it cashes the cheques and transfers the money to the RoS. The Commission recognises these amounts within its cash and cash equivalents balance, with a corresponding liability, so the net effect in the Commission's accounts is zero.

30. The Commission continues to hold approximately £5,600 on behalf of the Highlands & Islands Croft Entrants Scheme ("HICES"), which is no longer operating. This was a joint venture between the predecessor Crofters' Commission and other public sector bodies to provide an incentive for elderly/inactive crofters to assign their tenancy to new entrants to crofting. The Commission should prioritise discussions with the other HICES bodies with a view to winding up this bank account and allocate the funds as appropriate.

Refer to action point 3

Financial planning

31. In our annual report last year, we noted that the Commission did not approve its 2013/14 budget until after the start of the financial year. We note that the Commission approved its 2014/15 budget on 26 March 2014, before the start of the financial year.

32. Following the announcement of the 2014/15 Scottish Budget, the Commission's core budget will be £2.547m in 2014/15.

33. As a result of additional requirements under the Crofting Reform (Scotland) Act 2010, the Commission's responsibilities have increased, which will have a corresponding impact on the Commission's expenditure in coming years. As a result, the Commission received permission from the Scottish Government to overspend its budgets for the next three years up to the value of £310,000 per annum. This will largely consist of additional staff posts agreed with the Scottish Government for which recruitment is in progress.

34. The Commission should monitor closely its budget in the coming years to ensure that it operates within its overall funding allocation.

Refer to action point 2

Crofting Information System

35. The new Crofting Information System, which will replace the Commission's current Crofting Administration Database, is currently being developed. Management began purchasing servers and associated IT equipment in 2013/14.

36. Since April 2014 management has started to develop the software for the system in-house. We have agreed with the Head of Finance that the Commission will capitalise staff time spent developing the new system in 2014/15 and we will revisit this next year.

37. The Commission should monitor closely the expenditure on this project to avoid overspending its budget.

Refer to action point 2

Ex Gratia Payment

38. We identified that the Commission has made an ex-gratia payment of £57,000 to an employee who left the Commission during 2013/14. This payment was split between 2013/14 and 2014/15. As Commission staff are employed by the Scottish Government and seconded to the Commission, this was negotiated by the Scottish Government's Human Resources team. We are satisfied with the accounting treatment of this payment.

Corporate governance and systems of internal control

Overall governance arrangements

39. 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 sound governance arrangements in place which included a number of standing committees overseeing key aspects of governance.

40. In our 2013/14 Annual Audit Plan, we raised the issue that the Commission was not operating with a full complement of Commissioners. We note that the vacancies have now been filled by Marina Dennis and David Campbell.

Accounting and internal control systems

41. 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.

42. The Commission relies on the Scottish Government's Human Resources and Payroll services. Further, Scottish Natural Heritage ("SNH") provides the Commission's financial ledger. Audit Scotland undertakes the external audit of the Scottish Government and SNH.

43. No material weaknesses in the accounting and internal control systems were identified during the audit of the Commission, the Scottish Government 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.

44. Internal audit is an important element of the Commission's governance structure. We have adopted a substantive testing approach to our audit in 2013/14 and therefore, did not place reliance on any of the controls testing undertaken by Scott Moncrieff (Internal Audit) this year.

We did, however, place reliance on Internal Audit's work in terms of our wider Code responsibilities and in our review of the assurances relied upon for the Governance Statement.

45. In March 2014, the Commission approved its Corporate Plan 2014-17. However, we note that the Commission has yet to develop a Business Plan.

Refer to action point 4

46. Between July 2013 and February 2014, the Commission was without a Finance Manager, following the departure of the previous post holder. During this period, the Head of Finance covered this role. However, the Commission appointed Neil MacDonald as Finance Manager on a full-time basis in February 2014.

47. The Commission is based in Great Glen House, which it shares with the building's owners, SNH. As reported in our 2012/13 Annual Audit Report, management had agreed an amendment to the Memorandum of Terms of Understanding ("MOTU"). We can confirm that this was signed in March 2014 and is in operation.

Governance Statement

48. In our 2013/14 Annual Audit Report, we highlighted the need for the Accountable Officer to obtain assurances from the Scottish Government regarding the HR and Payroll systems, from SNH regarding the financial ledger and from the Commission's Senior Management Team to ascertain whether there were any internal control weaknesses in the year.

49. We are pleased to report that these assurances have now been obtained, as described in the 2013/14 Governance Statement.

Prevention and detection of fraud and irregularity

50. In our Annual Audit Plan we highlighted the responsibility audited bodies have for establishing arrangements to prevent and detect fraud and other irregularities.

51. In 2013/14, the Commission formally adopted the Scottish Government's fraud policies, as contained in the Scottish Public Finance Manual. However, the SPFM contains high-level policies for fraud and requires organisations to develop their own detailed fraud policies that comply with the SPFM. The Commission should prioritise the implementation of its own detailed fraud policy.

Refer to action point 5

Register of Interests

52. Two of the nine Commissioners have not updated their Register of Interests since 2012. One has just been appointed in June whose Interests have not yet been published. The Commission relies on a staff Register of Interests that is held by the Scottish Government, however, the Commission does not have ready access to this Register.

53. We recommend that all staff and Commissioners should update their Register of Interests entry at least annually. The Commission should perform a review of the Register of Interests at least annually to identify any potential conflicts of interests for senior management that may require disclosure under IAS 24.

Refer to action point 6

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

54. 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

55. Accountable officers are required to put in place appropriate arrangements to satisfy their duty of best value.

56. In our 2012/13 Annual Audit Report, we noted that the Commission had not undertaken a self-evaluation of its Best Value work, in accordance with March 2011 Scottish Government guidance. We recognise that the Commission needs to be proportionate in its approach to implementing Best Value. However, the Commission has still not performed a formal self-assessment.

Refer to action point 7

Acknowledgements

57. We would like to express our thanks to the Commission's staff 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 1: Key Audit Risks

Key Audit Risks and Associated Audit Work

Audit Risk	Overview of the scope of audit work to address the risks
Corporate Plan The Commission does not have a Corporate Plan or a Business/Operational Plan. As a result, the Commission has delayed the introduction of Key Performance Indicators ("KPIs") and a detailed review of its Risk Register until the Corporate Plan has been approved.	During the Audit, we confirmed that the Commission approved its Corporate Plan 2014-17 in March 2014. We discussed this with the Head of Finance, who confirmed that work will take place to develop a set of KPIs based on the Corporate Plan. Management has prepared a draft risk register, which has been presented to the June 2014 Board and the July 2014 Audit and Finance Committee for detailed scrutiny. Thereafter, the Board will take ownership of the Risk Register.
Projected Overspend Within Budgets The Commission overspent its capital budget in 2012/13, and also overspent its total Grant in Aid budget as a result of non-cash adjustments following our audit findings. The Commission obtained approval for this from its sponsor department. For 2013-14, the Commission is projecting a £90,000 capital overspend and a £40,000 overspend in its legal services budget. Management have confirmed that both overspends will be funded by virement from its revenue budget.	We were aware of the risk of an overspend and addressed this as part of our final accounts audit in June 2014. As noted at paragraph 23, the Commission overspent both its Resource DEL and amortisation budgets by a total of 1.5% on an accruals basis. We requested that the Commission obtains Scottish Government approval for the overspend. We note the Commission underspent its cash budget, drawing down 99.8% (£2.543m) and spending 99.4% (£2.531m) of its £2.547m cash budget.
Register of Crofts The Commission plans to replace the existing Register of Crofts. It will be important to maintain expenditure within budget, as failure to do so could have an adverse impact on the Commission's	We revisited this at our final accounts audit and directed audit testing of non-current asset additions to identify assets relating to the replacement Crofting Information System.

Audit Risk	Overview of the scope of audit work to address the risks
finances.	The Commission has purchased IT equipment during 2013/14 for the development of the new Crofting Information System. The Commission has begun to develop the system in-house during 2014/15.
Commissioner Resignations We note that the Commissioner who chairs the Audit and Finance Committee has resigned, and that another Commissioner is going on sabbatical during 2013/14. The Commission should ensure that it operates with a full complement of Commissioners with adequate experience.	We reviewed progress on appointing replacement Commissioners throughout the year. Marina Dennis and David Campbell have been appointed.
Closedown Procedures During our 2012/13 audit, we noted that the Commission's closedown procedures could be further improved by including a more detailed timetable for the preparation of the financial statements.	We reviewed this as part of our financial statements audit in June 2014. The Head of Finance provided a detailed closedown timetable, which is appropriate for the Commission's purposes. In addition, work is underway to develop detailed desk instructions to document the Commission's procedures for preparing the annual report and accounts.
Lack of IT and Business Continuity Plans The Commission does not have any formally adopted IT policies or a business continuity plan. Any policies that the Commission has are Scottish Government policies, and do not specifically relate to the Commission.	The Commission has now developed a business continuity plan. Work is still required to develop an IT strategy.

Appendix 2: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	17	Assets are not easily identifiable on the asset register: assets do not have unique reference numbers and several assets are grouped in one line in the asset register.	Management will tag all assets with a unique identification number and ensure that all assets have an individual entry on the asset register.	Head of Finance	31/03/15
2	23, 34, 37	The Commission overspent its Resource DEL in 2013/14. We note that work is ongoing to develop the Crofting Information System during 2014/15. Management has obtained Scottish Government approval for this overspend. The Commission should monitor closely its budget in 2014/15 to minimise the risk of overspend, notwithstanding Scottish Government assurances.	The Commission will liaise closely with the Scottish Government sponsor branch to ensure compliance with its total allocation	Head of Finance	31/03/2015
3	30	The Commission continues to hold approximately £5,600 on behalf of the Highlands & Islands Croft Entrants Scheme (HICES), which is no longer operating.	This was deferred due to the staffing issues referred to in paragraph 46 and will be progressed during	Head of Finance	31/03/2015

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		Management should prioritise discussions with the other HICES bodies with a view to winding up this bank account	the current year.		
4	45	The Commission has approved its Corporate Plan 2014-17, however it has not implemented a Business Plan.	To be confirmed with Chief Executive in advance of Audit and Finance Committee meeting.		
5	51	The Commission has not implemented a formal fraud policy, but has adopted the Scottish Government's fraud policy as contained in the SPFM. The SPFM requires the Commission to develop its own fraud policy, which should comply with the requirements of the SPFM.	Agreed	Head of Finance	31/03/2015
6	53	Two of the nine Commissioners have not updated their Registers of Interests since 2012. One recently appointed Commissioners' details have not yet been published. In addition, the staff register of interests is not readily accessible. The Commission does not perform a review of	A twice-yearly review of Commissioners' interests and an annual review of staff interests will take place	Head of Finance/Chief Executive	31/03/2015

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		senior management's declarations for potential Related Parties transactions that require disclosure under IAS 24.			
7	56	The Commission has not undertaken formal self-assessment of its Best Value performance. We reported this in our Annual Audit Report in 2012/13.	Review to be scheduled with internal audit during 2014-15	Head of Finance	31/03/2015