AUDIT SCOTLAND

Forestry Commission Scotland and Forest Enterprise Scotland

Annual audit report 2014/15

July 2015

Contents

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This report has been prepared for the use of Forestry Commission Scotland (FCS) and Forest Enterprise Scotland (FES) and no responsibility to any member or officer in their individual capacity or any third party is accepted.
This report will be published on our website after it has been considered by the audit committee. The information in this report may be used by Audit Scotland in any reporting to the Scottish Parliament.

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Key Messages

Audit of financial statements	• Unqualified independent auditor's reports on the 2014/15 financial statements for FCS and FES • Forest estate revaluation reserves have been correctly adjusted
Financial management and sustainability	• FCS operated within resource budgets for 2014/15 • FCS has breached its Budget Act limit on income and has to repay £2.3m to the Scottish Government • There is no medium or long term financial planning in place for FCS and FES
Governance and transparency	• FCS and FES had sound governance arrangements • Overall systems of internal control operated effectively during 2014/15, however we identified weaknesses in the trade payables system and issues in this area were also highlighted by the National Fraud Initiative exercise • Related parties disclosures in FCS and FES were incomplete
Best value	• Arrangements for Best Value are satisfactory

Introduction

1. This report is a summary of our findings from the 2014/15 audits of Forestry Commission Scotland (FCS) and Forest Enterprise Scotland (FES).

2. The management of FCS and FES are responsible for:
   - preparing financial statements which give a true and fair view
   - ensuring the regularity of transactions, by putting in place systems of internal control
   - maintaining proper accounting records
   - preparing and publishing their financial statements, an annual governance statement and a remuneration report.

3. Our responsibility, as the external auditor of FCS and FES, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.

4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; that have been prepared by management with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.

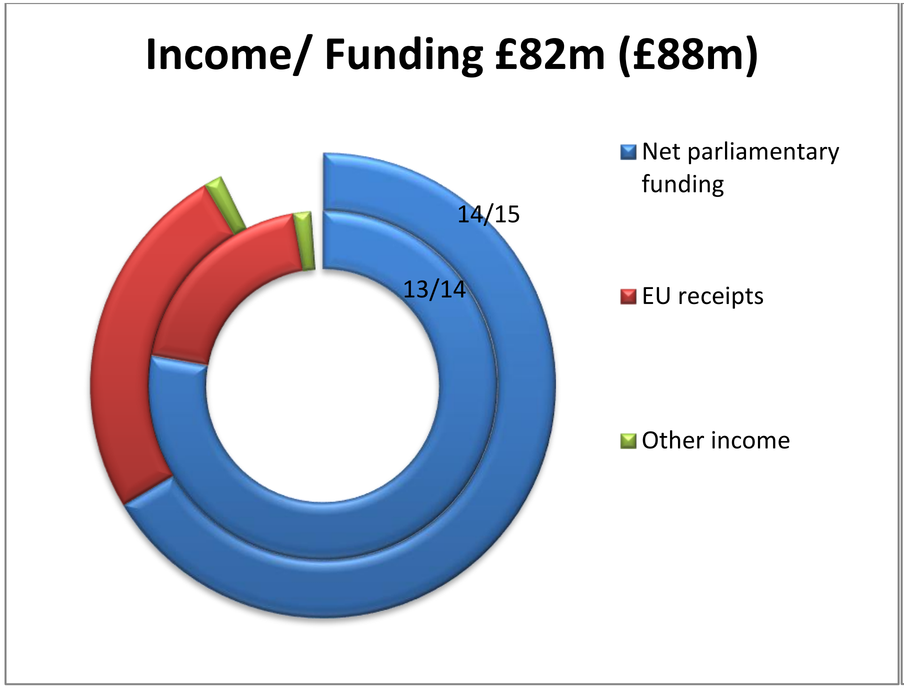
5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports are summarised at appendix II and appendix III.

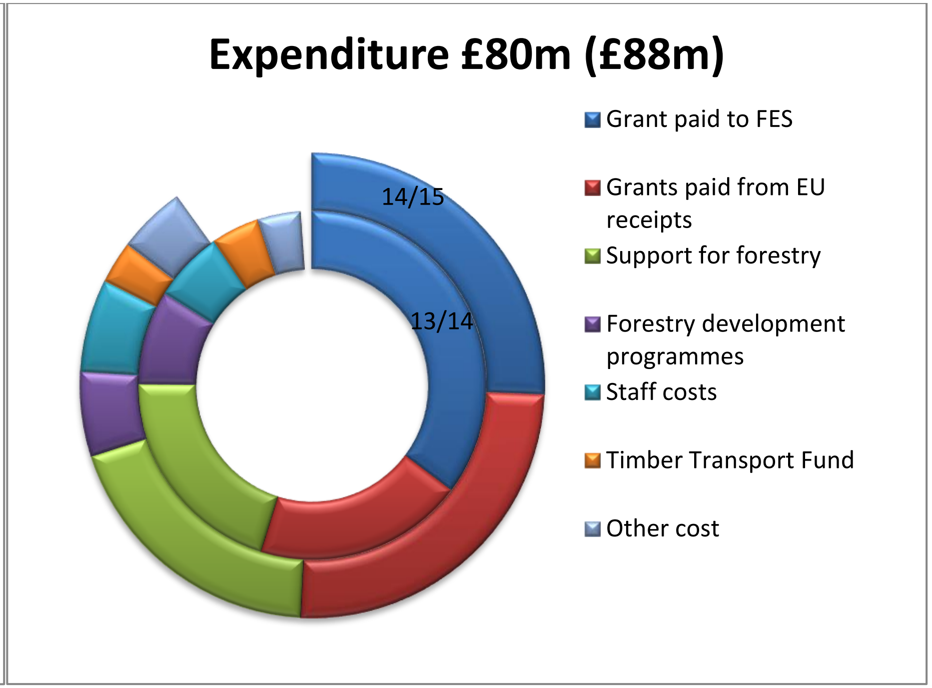
6. Appendix IV is an action plan setting out our recommendations to address the high level risks we have identified from the audit. We recognise that not all risks can be eliminated or even minimised. What is important is that FCS and FES understand their risks and have arrangements in place to manage these risks. The committee should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.

7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures. Consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

8. We would like to express our thanks to FCS and FES staff and management for their help and assistance during the audit of this year’s financial statements.

2014/15 FCS financial statements

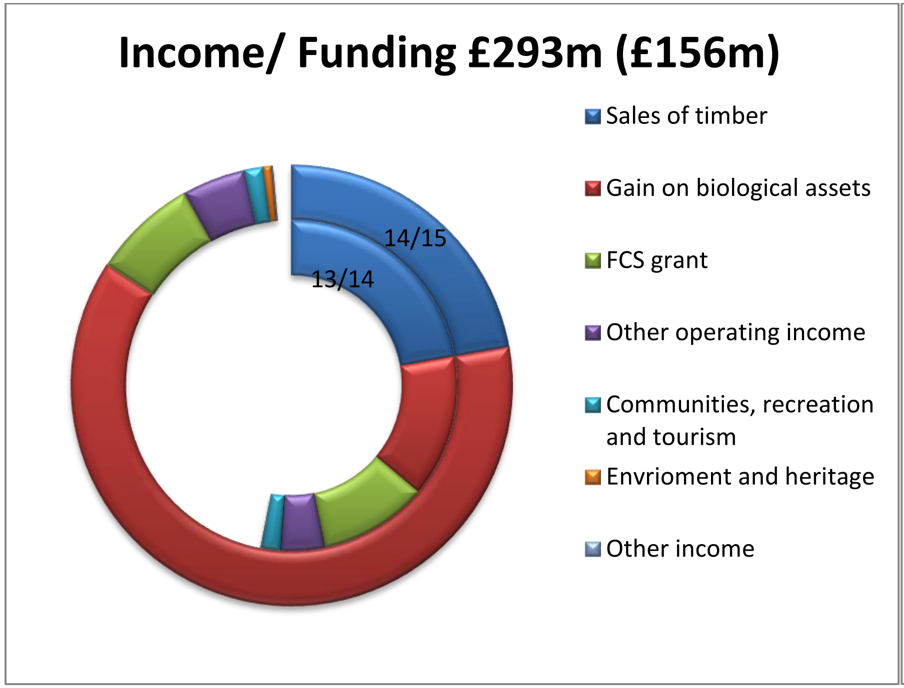


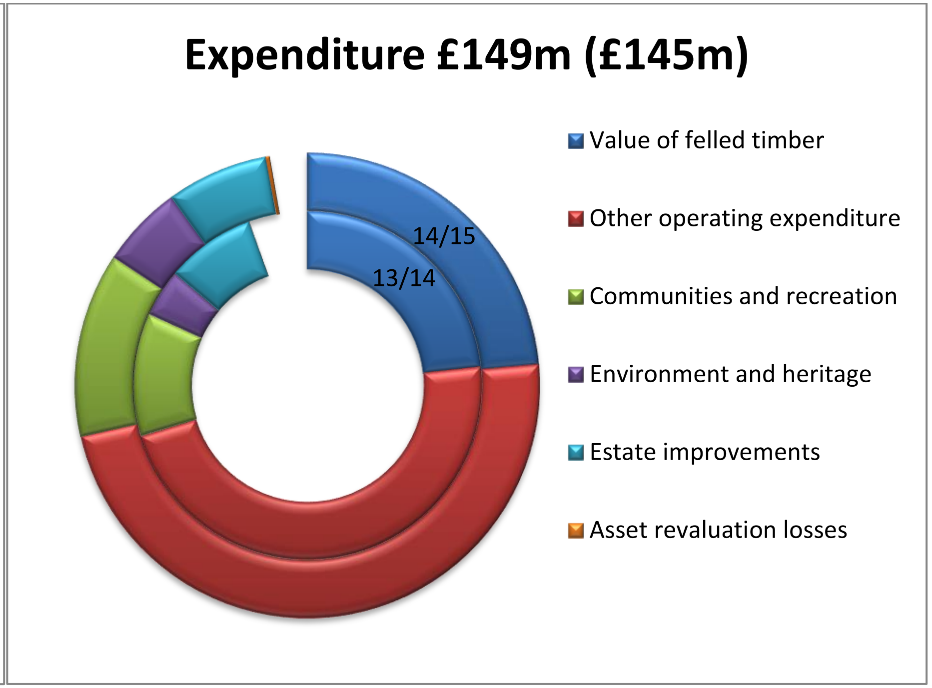


Income and funding of £82m is £6m (7%) less than last year. Scottish Government (SG) funding decreased by £10m (15%), but there were increases in European funding (£5m).

Expenditure decreased by £8m (9%) to £80m. The main decrease was in grant paid to FES (£10m), offset by an increase in EU grants payments made to private land owners (£5m).

2014/15 FES financial statements





There has been a significant gain on biological assets this year (£184m) compared to last year (£41m). Excluding this unrealised gain, income and funding of £108m is £7m (6%) less than last year mainly due to a decrease in FCS grant funding of £8.5m (27%).

Expenditure increased by £4m (3%) to £149m. The main increase was in communities, recreation and tourism (£2.2m)

Within other operating expenditure there was an increase in forest protection and maintenance, due to expenditure on the continued fight against tree diseases and the network of forest estate roads.

Audit of FCS and FES 2014/15 financial statements

Audit opinions

Financial Statements	•The financial statements of Forestry Commision Scotland and Forest Enterprise Scotland for 2014/15 give a true and fair view of the state of the bodies' affairs and of their net expenditure for the year. •We confirm that the financial statements have been properly prepared in accordance with the 2014/15 FReM and the requirements of the Forestry Act 1967 and relevant directions.
Regularity	•In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance. •For FCS the sums paid out of the Scottish Consolidated Fund for the purpose of meeting the expenditure shown in the financial statements were applied in accordance with section 65 of the Scotland Act 1998.
Other prescribed matters	•The remuneration reports to be audited have been properly prepared in accrodance with the requirements of the Forestry Act 1967 and relevant directions. •The information in the Management Commnetary is consistent with the financial statements.

Submission of financial statements for audit

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

Overview of the scope of the audit of the financial statements

10. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audits, were outlined in our Annual Audit Plan presented to the Audit and Risk Committee on 13 March 2015.

11. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2014/15 agreed fees for the audits were set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fees remain unchanged.

12. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

13. Appendix I sets out the significant audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

14. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

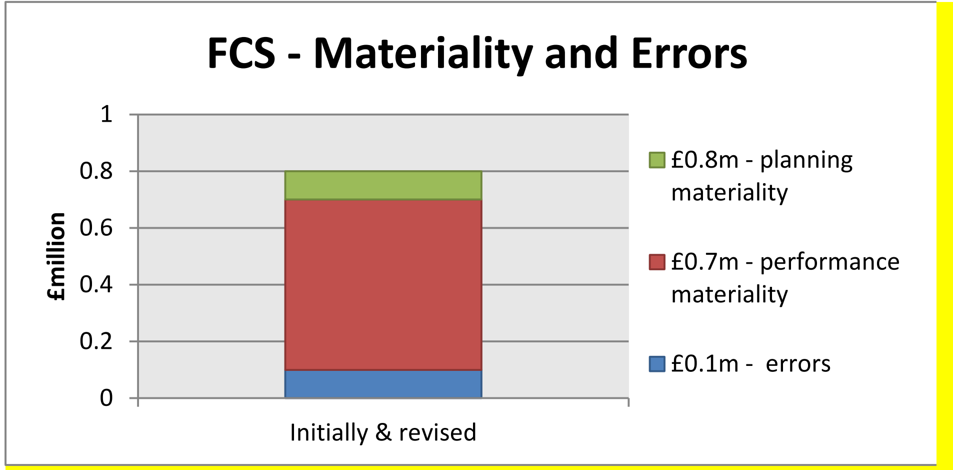
15. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. We assess the materiality of uncorrected misstatements, both individually and collectively.

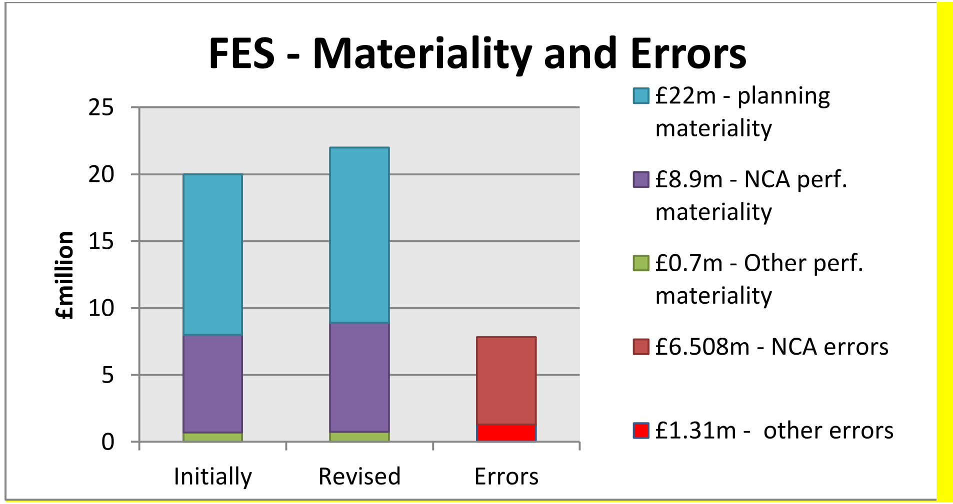
16. We summarised our approach to materiality in our Annual Audit Plan. Based on the financial statements, we revised our planning materiality for 2014/15 to:

- **FCS** £0.8m (1% of gross expenditure). Performance materiality of £0.7m is determined to ensure that uncorrected and undetected audit differences do not exceed our planning materiality level (unchanged from our Annual Audit Plan).
- **FES** £22.3m (1% of gross assets). Performance materiality was set at £ £8.9m for biological assets, forest estate and land. For the remaining items in the statement of financial position and all items in the statement of comprehensive

net income we have set a separate performance materiality level of £ £0.7m.

17. We report all misstatements greater than £40,000.





Evaluation of misstatements

18. We have identified one misstatement above our £40,000 threshold in FCS financial statements. The trade and other payables figure is overstated by £0.1m with the Statement of Changes in Taxpayers Equity similarly overstated. Management did not consider this to be material and have not adjusted the accounts.

19. We have identified a number of errors in the unaudited FES accounts which management adjusted in the audited version. The errors resulted in a reduction in net surplus of £1.31m. The majority of this adjustment related to the impact of changes in Non Current Asset valuations (£1.2m) with the remainder attributable to other account areas. The total adjustment to non current asset valuations in the Statement of Financial Position was £6.508m, with most of this affecting the revaluation reserve. The most significant adjustments are described in paragraphs 26 and 27.

20. The errors identified did not breach the related performance materiality level of £8.9m for non current assets. However the effect of errors in FES' net surplus did exceed the performance materiality level of £0.7m for other account areas. Therefore, we revised our planned audit approach and undertook additional audit testing particularly of impairments, where we noted that errors had occurred across all categories of assets. As a result we reviewed land, forest estate, biological and buildings asset impairments and did not identify any indication

that further systematic undetected errors exist within the account area or more pervasively within the financial statements.

21. We have also identified a number of disclosure and classification adjustments, including incomplete related parties' disclosures (paragraph 28).

Significant findings from the audit

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

- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and disclosures.
- Significant difficulties encountered during the audit.
- Significant matters arising from the audit that were discussed, or subject to correspondence with management.
- Written representations requested by the auditor.
- Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

23. A number of presentational and monetary adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements. The overall effect of the adjustments made to the FES financial statements is to decrease total comprehensive net income by £1.3m. A summary of the main adjustments is contained in the following table together with significant issues that, in our view, require to be communicated to you in accordance with ISA 260.

Significant findings from the audit in accordance with ISA260

24. **Open cast mines.** In our 2013/14 report we explained our judgment on the contingent liability disclosure of £21.2m for the potential exposure to remediation costs for the forest estate sites with opencast mines. In 2014/15 the contingent liability has been reduced to £17.4m. The reduction reflects new arrangements between FES and East Ayrshire Council (The Council). The Council has agreed a revised restoration plan and contracted for the restoration works for the Dunston Hill site. The Council will use £3m of its bond money to fund the work. Similar arrangements are expected to be agreed for the Skares Road/Netherton site. Limited progress has been made on the remaining two sites in the Chalmerston area and therefore the estimate of this part of the liability has not changed since last year. There is a possibility of FES being liable for restoration costs. This is disclosed as a contingent liability in the accounts.

25. **Revaluation reserve balances.** In previous years we reported that FES revaluation reserve balances were not allocated to individual assets in accordance with accounting requirements for forest estate, other land, vehicles, machinery and equipment (VME). The revaluation reserve issues with VME and other land were addressed in 2012/13 and 2013/14. This year (2014/15), FES completed a review of forest estate revaluation reserve balances and made the necessary adjustments in the financial statements. These adjustments are identified in Note 26 in the Annual Report and Accounts.

26. **Other land impairment.** During our pre-year end testing the head of acquisitions and disposals advised us that land at Rosal was subject to wind damage and consequently a potential buyer withdrew from acquiring it. On review of FES land impairments we noticed that the asset had not been impaired by surveyors and its lower value was therefore not reflected in the unaudited accounts. The adjustment has been made in the audited financial statements. As a result the value of this asset has decreased by £4.3m.

Action point 1

27. **Wind Farm valuations.** We identified that FES used the old valuation information provided by Bell Ingram (appointed valuers) instead of the most up-to-date schedules, in preparing the unaudited financial statements. The audit adjustment resulted in a decrease in the value of wind farms by £2.2m. Management informed us that the procedures will be improved for next year.

28. **Related parties disclosures.** We reviewed related parties disclosures in the accounts and compared these to income and expenditure documentation and to our wider knowledge of potential related parties transactions. We noted that both the FCS and FES disclosures were incomplete and inaccurate. A total of £0.8m of FES related parties transactions had not been disclosed in the notes to the accounts. We also found that the published register of interest for FCS and FES management board members had not been updated since 24 February 2014 and it did not include key members of these bodies.

Action point 2

Future accounting and auditing developments

Revisions to the Financial Reporting Manual (FReM)

29. The financial statements are prepared in accordance with the Government financial reporting manual (FReM). Two significant revisions will apply from 2015/16:

- Adoption of IFRS13 *Fair value measurement* for the first time – this also includes IAS 16 and IAS 38 adaptations.
- Simplification and Streamlining Project – changes to the form and content of the annual report and accounts.

30. **International Financial Reporting Standards (IFRS)13 Fair value measurement:** sets out the requirements for assets to be to be valued at fair value and is applied in full by the FReM only to assets that are not held for their service potential (i.e. investment properties and assets held for sale). It also applies to operational assets which are surplus to requirements where there are no restrictions on disposal which would prevent access to the market.

31. IFRS 13 does not apply to operational assets which are in use delivering front line services or back office functions, and surplus assets with restrictions on their disposal. These will be valued in accordance with the adaptions to *IAS (International Accounting Standard) 16 property, plant and equipment.*

32. **International Accounting Standard (IAS) 36 Impairment of assets:** this amendment seeks to address the implications of references to IFRS 13 'Fair Value Measurement', and modifies some of the disclosure requirements regarding measurement of the recoverable amount of impaired assets.

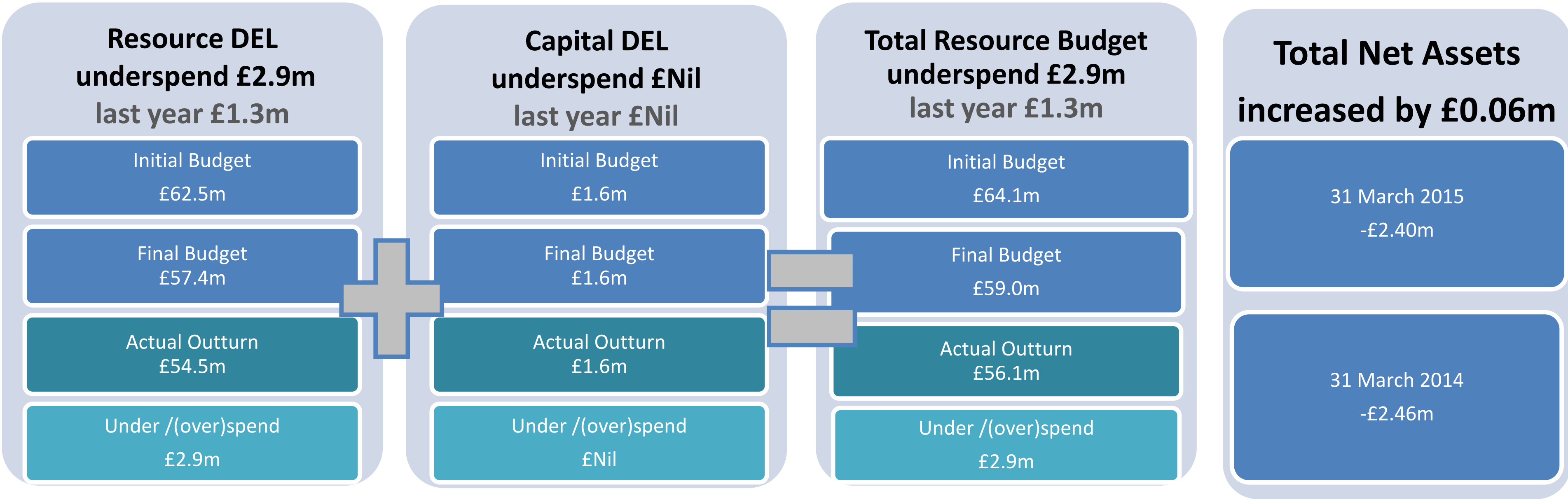
33. **Restructuring of the annual report**: the 2015/16 FReM has been extensively re-written to require the annual report and accounts to include:

- a performance report which will give a fair, balanced and understandable analysis of performance and will include and overview section and a performance analysis section.

- an accountability report incorporating the following three main sections:
  - corporate governance report consisting of a directors' report, a statement of the Accountable Officer's responsibilities and a governance statement
  - remuneration and staff report which will cover a number of prescribed disclosures including remuneration policy, payments to directors, staff numbers and sickness absence rates
  - parliamentary and accountability report which will include information on the regularity of expenditure and the independent auditor's report.

Action point 3

FCS financial management and sustainability



In addition to its resource budget above, Forestry Commission Scotland also had an AME budget of £0.6m of which £0.2m has been used.

34. The main financial objective for Forestry Commission Scotland is to ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers. FCS operated within the resource budgets for 2014/15 as detailed above. During the year the Scottish Government agreed to transfer £5.1m of budget including a transfer to the Central Scotland Green Network Trust.

35. The Budget (Scotland) Act identifies a cash authorisation limit for Forestry Commission Scotland, in addition to the above budgets. The 2014-15 Spring Budget Revision

(http://www.gov.scot/Resource/0046/00469567.pdf) identified a cash authorisation limit of £58.9m. This full amount was drawn down by FCS, but the "amount issued from Scottish Consolidated Fund (SCF) and not spent at year end" is £2.6m and is shown as a creditor to the Scottish Government in the financial statements. In addition to the budgetary expenditure limits set out in the Budget Act, there is also total limit on income (accruing resources) relevant to FCS. This limit was £21.1m. FCS exceeded this limit by £2.3m (total income of 23.4m). The higher than expected income is a result of timing differences in receiving European Union (EU) grants.

36. In order to comply with the Budget Act and Scottish Public Finance Manual FCS needs to repay the £2.3m to the Scottish Government. We understand that this issue does not result in any change to the financial statements, therefore the year end creditor remains, in total, as £2.6m.

37. Management have advised that that this is an unusual occurrence. Therefore a report to the Finance Committee of the Scottish Parliament may be required from SG Finance. Management have agreed to improve the monitoring of income in future years to ensure that the limit is not breached.

Action point 4

2014/15 financial position

38. At 31 March 2015 FCS has a negative total net assets of £2.4m, which is slightly improved on 2014

39. The financial position of FCS remains stable with the body operating within its available income and funding (on an accounting and resource basis) but a shortfall of total and current assets over liabilities.

40. FCS has only a high level financial plan for 2015/16. We are aware that FCS relies heavily on Scottish Government funding and the last comprehensive spending review covered the three years from 2012/13 to 2014/15. The Scottish Government spending review covering the three years from 2016/17 to 2018/19 is expected this autumn. As reported in "Scotland's Public Finances follow-up audit: Progress in meeting the challenges" from June 2014, our expectation is that each body in the Scottish public sector would have a medium term financial budget for the following 2 years, based on assumptions of future grant-in-aid provision.

Action point 5

Financial management

41. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:

- the Chief Financial Officer has sufficient status to be able to deliver good financial management
- standing financial instructions and standing orders are comprehensive, current and promoted within the body

- reports monitoring performance against budgets are accurate and provided regularly to budget holders
- monitoring reports do not just contain financial data but are linked to information about performance
- members provide a good level of challenge and question budget holders on significant variances.

42. Based on our accumulated knowledge, our review of board papers and through our attendance at committees we conclude that FCS has satisfactory financial management arrangements in place.

FES financial management and sustainability

FES annual outturn and financial position

43. FES achieved a surplus of £144m in 2014/15 (2013/14 - £11.1m). The main reason for an increase in surplus is the gain on biological asset value of £184m in 2014/15 compared to £41m in 2013/14.

44. FES net assets of £2.2 billion have increased by £0.1 billion since last year. This was again due to the increase in the value of biological assets, which was caused by rising woodland values and timber prices.

45. £7.4m, of £15.5m, cash carried forward into 2014/15, has been used for the purchase of the Upper Rothiemurchus land in April 2014. At 31 March 2015 FES carried forward £7.6m of unspent cash to 2015/16 (within 10% of the turnover). The majority of this balance relates to future commitments for restocking and tree health issues (£4.5m), cash bond for coal mines restoration (£1.8m) and the Cuningar Loop project (£1.1m).

46. FES has a high level business plan for 2015-17. As reported in *"Scotland's Public Finances follow-up audit: Progress in meeting the challenges"* it is important that public bodies develop detailed financial plans that outline spending commitments over the short (one year) and medium term (two to five years).

Action point 5

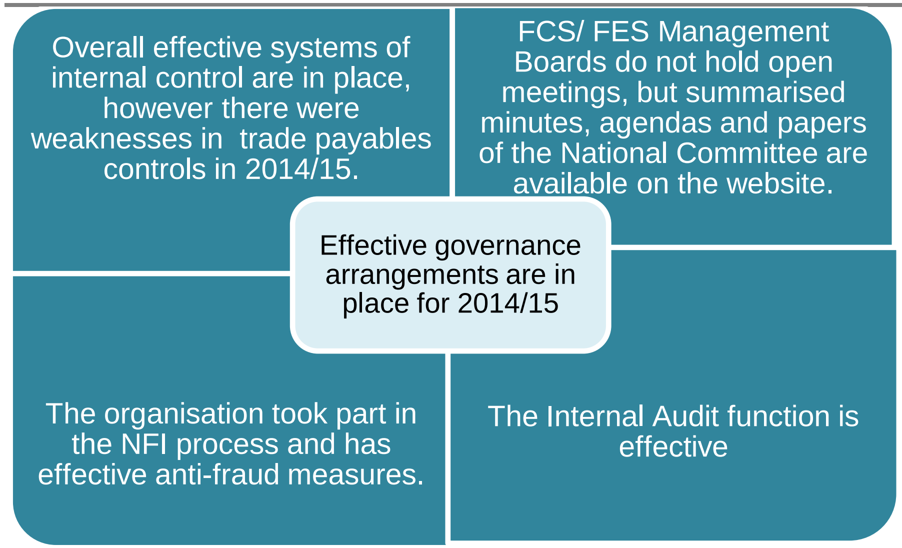
Financial management

47. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:

- the Chief Financial Officer has sufficient status to be able to deliver good financial management
- standing financial instructions and standing orders are comprehensive, current and promoted within the body
- reports monitoring performance against budgets are accurate and provided regularly to budget holders
- monitoring reports do not just contain financial data but are linked to information about performance
- members provide a good level of challenge and question budget holders on significant variances.

Based on our accumulated knowledge, our review of board papers and through our attendance at committees we conclude that FES has satisfactory financial management arrangements in place.

Governance and transparency



Corporate governance

48. Forestry Commission Scotland is managed by a Board of Commissioners and they are statutorily responsible for the stewardship of the estate placed at their disposal by Ministers. The Commissioners have delegated to the statutory National Committee for Scotland the normal exercise of their powers and duties in connection with the estate and the delivery of forestry policies.

49. The Board meets four times a year. As forestry is a devolved matter, the Commissioners report separately to UK Ministers and Scottish Ministers.

50. The National Committee for Scotland has established an Audit and Risk Committee (ARC) to support it in its responsibilities for the effective management of risk, control and governance.

51. FCS manages the public forest estate through its Agency, FES, to deliver public benefits. The Minister for Environment, Climate Change and Land Reform is answerable to the Scottish Parliament for the overall policies and performance of Forestry Commission Scotland.

52. We concluded that the FCS and FES have effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

53. Bob McIntosh had a dual role as Director Scotland and Director of Environment and Forestry in the SG. He retired in February 2014 and his role at the SG was taken over by Bridget Campbell. Dr McIntosh's responsibilities at FCS were taken over by Jo O'Hara (Deputy Director) who became accountable officer. Simon Hodge continues to be accountable officer for

FES. Both Jo O'Hara and Simon Hodge now report directly to Bridget Campbell.

Transparency

54. The Scottish Government's On Board guidance (http://www.gov.scot/Publications/2015/04/9736/0), for board members of public bodies was updated and reissued in April 2015. On Board states that boards should demonstrate high standards of corporate governance at all times including openness and transparency in decision making. It recommends boards should consider:

- Holding an annual open meeting
- Holding board meetings in public unless there is a good reason not to
- Publishing summary reports and/or minutes of meetings
- Inviting evidence from members of the public in relation to matters of public concern
- Consulting stakeholders and users on a wide range of issues
- Making corporate plans and the annual report widely available.

55. Audit Scotland also believes in transparency of financial reporting within the Annual Report and Accounts including:

- A clear reconciliation between expenditure and the outturn against Scottish Government Resource budgets.
- Identification of, and explanation of, any significant movements in budget during the year.

56. Forestry Commission Scotland makes available a range of information on their website. FCS published a Strategy for Scotland's Forest Estate and the Scottish Forestry Strategy: progress report (2014-15) and future implementation (2015-18).

57. The National Committee for Scotland's agendas, meeting papers and minutes are available on the Forestry Commission website. The Scottish management boards of FCS and FES do not make their agenda papers available for public.

Internal control

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

59. In our report to management in May 2015 we identified a number of issues in the trade payables area relating to bank details changes and authorisation limits. These could adversely affect the organisation's ability to record, process, summarise and report financial and other relevant data although we don't

believe these would result in a material misstatement in the financial statements.

Action point 6

ICT audit

60. As part of our 2013/14 audit of FCS and FES, we conducted a high-level risk based assessment of Information Services We also reviewed Internal Audit's "Progress Review on Information and communications technology Infrastructure Development & Disaster Recovery", which was issued in October 2013.

61. In 2014/15 audit, we met with management to determine whether the findings and agreed actions have been addressed. The summary of our findings was issued in a letter to the management on 17 April 2015. Of the ten actions identified in 2013/14, four have been fully completed, three have been partially completed and there has been no action on the remaining three. We have agreed revised dates with management for the outstanding actions.

Internal audit

62. Internal audit provides the Audit and Risk Committee and accountable officers with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.

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

64. The internal audit plan for 2014/15 was materially complete. We were able to place formal reliance on aspects of internal audit work on the trade payables and grants expenditure.

Arrangements for the prevention and detection of fraud

65. 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 overall arrangements for the prevention of fraud within FCS and FES are sound, although it should be noted that no system can eliminate the risk of fraud entirely.

National Fraud Initiative in Scotland

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

67. Auditors are required to assess the arrangements that bodies have put in place to prevent and detect fraud, including how they approach the NFI exercise itself.

68. The National Fraud Initiative has a high profile within FCS and FES with data matches actively investigated and findings regularly reported to the Audit and Risk Committee.

69. As part of this year's NFI exercise, FCS and FES submitted Payroll and Creditors data and the matching process identified 1,271 records for investigation with 329 of these "recommended" for investigation. To date, all recommended matches have been investigated.

70. Consequently, NFI exercise identified 5 errors with the total value of £35,387. Four of these related to duplicate payments made by FCS and FES and one related to overpaid VAT. Management informed us that all of the duplicate payments have been recovered. We have noted control weaknesses earlier in this report and these NFI outcomes provide further evidence of weaknesses in this area. Management have agreed to further strengthen controls in this area.

Action point 6

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

71. 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

72. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.

Arrangements for securing Best Value

73. 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 FCS and FES, agree to undertake local work in this area.

74. FCS and FES have in place a rolling programme of Best Value reviews to ensure continuous improvement in securing best value within both organisations. Two to three best value reports (one out of each category) are presented to the Board in each financial year. Reviews of governance and accountability and people management were completed during 2014/15. Vision and strategic direction, public performance reporting and procurement areas were also covered as a part of ongoing processes.

National performance audit reports

75. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. As mentioned in paragraph 40 and 46 Audit Scotland issued a follow-up report on Scotland's Public Finances. http://www.audit-scotland.gov.uk/docs/central/2014/nr_140605_public_finances.pdf

76. The report recommended that public bodies should:

- implement an approach to budgeting that focuses more on priorities and links planned spending more closely with the outcomes they want to achieve
- develop a longer-term approach to financial planning that takes account of priorities, risks and liabilities and provides assurances on long-term affordability
- support effective scrutiny by ensuring that good-quality information is available and that councillors and non-executive directors have the right skills to carry out their scrutiny roles.

Appendix I – Significant audit risks

The table below sets out the financial statement audit risks identified as a part of our planning, how we addressed each risk and our judgement in arriving at our opinion on the financial statements.

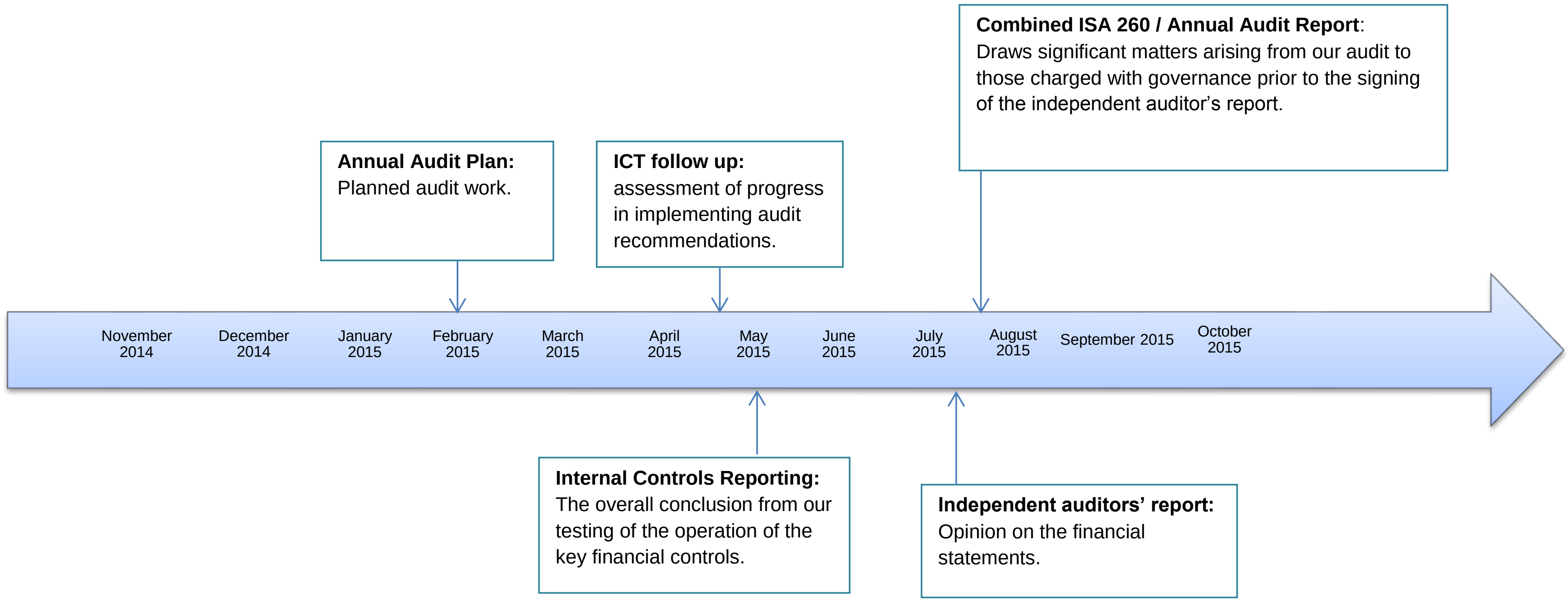
Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
Opencast coal sites potential liability (FES) FES disclosed a contingent liability in its 2013/14 financial statements in relation to potential exposure to remediation costs for the five forest estates sites with opencast mines. The extent and classification of liability depends on management assessment. *There is a risk of misstatement of the potential liabilities in the financial statements.*	Examined the judgements, accuracy and disclosure in the 2014/15 financial statements. We met with the management and head of estates to confirm our understanding of the situation Confirmed with East Ayrshire Council's external auditors the consistency of assumptions made within FES on the extent of remediation required compared to the bonds held.	Our audit work confirmed the completeness, accuracy and classification of the contingent liability for opencast mines restoration.
Unallocated revaluation reserve balances (FES) Revaluation reserve balances associated with the individual forest estate assets: comprising forest estate land and trees have not been transferred to general fund on disposal. *There is a risk that an increasing amount is misclassified between the revaluation reserve and general fund balances.*	Examined the adjustments made in interim accounts provided by the management and ensured they followed agreed methodology and were used in the financial statements provided for audit in May. Audited 2014/15 movements in Forest Estate assets to ensure the agreed treatment is being used.	We confirmed the accuracy of adjustments made and methodology now in use for allocation of revaluation reserve movements.

Audit Risk	Assurance procedure	Results and conclusions
Income (FES) The majority of income (£85.6m in 2014/15) was received from sources other than FCS grant. Included in the figure above is £65.8m from timber sales. *The extent, complexity and geographical dispersion of income sources means there is an inherent risk of fraud in accordance with ISA240.*	Performed controls testing during the West Argyll forest district visit including review of timber contract management, timber despatching, invoicing procedures and timber security arrangements. We completed substantive analytical procedures and sampling during the final accounts.	We have not identified any evidence of fraud or significant weaknesses in controls over income
Valuations of biological and related assets (FES) Significant elements of the financial statements are subject to annual valuation/indexation exercises that rely on the provision of valuations by management experts, including biological assets, forest estate and other land assets. *There is a risk of error in valuation assumptions used by the valuer and a risk of incorrect accounting for these complex changes.*	Our audit work considered the nature, scope and assumptions made in these valuations to enable us to place reliance on management's experts in accordance with ISA 500. Detailed substantive testing of a sample of the assets valuations during the financial statements audit.	We have identified a number of issues in relation to valuation and processing of impairments in the accounts as explained in paragraphs 26 and 27. These have been corrected in the audited financial statements and we extended our scope of testing of impairments to ensure significant coverage and address the risk of material misstatement.

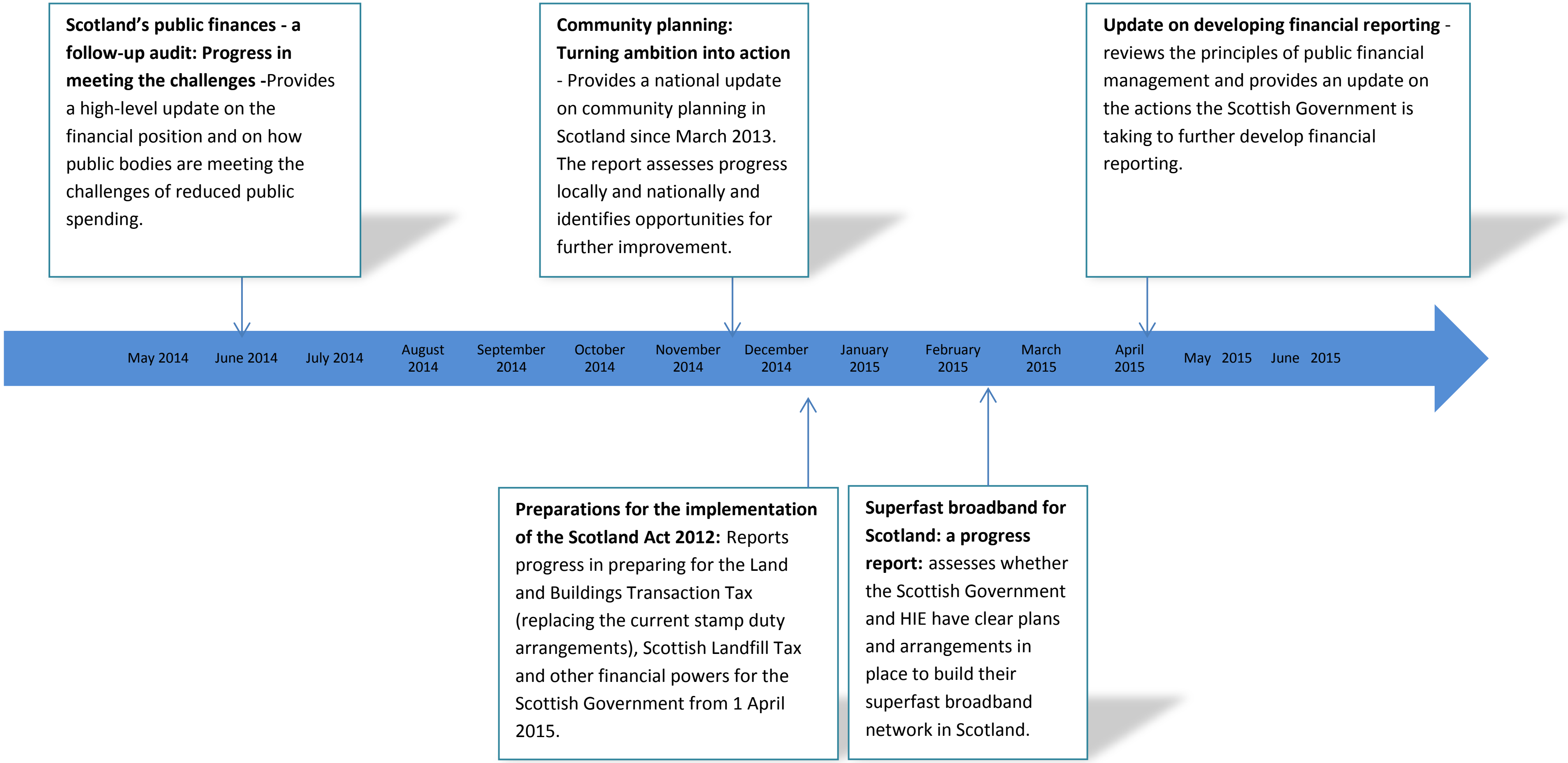
Audit Risk	Assurance procedure	Results and conclusions
HMRC inspection (FCS and FES) Following the HMRC inspection, negotiations between HMRC and FC for possible VAT under/overpayments are ongoing. Any agreement with HMRC could have implications for FCS and FES and could require additional disclosures and provisions. *There is a risk that required disclosures are not correctly classified or incomplete.*	We had regular discussions with management to ensure we understand current progress with the HMRC inspections and expectations in terms of tax liabilities. Examined the judgements, accuracy and disclosure in the 2014/15 financial statements. Considered whether there should be a post balance sheet event disclosure in relation to tax liabilities.	Our audit work found that tax liabilities have been settled in 2014/15. We were satisfied that these were accounted for correctly and disclosed as contingent liabilities
Tribunal overtime ruling (FES) As a result of the last year's Employment Appeal Tribunal rulings employers were required to calculate the holiday pay based not only on basic pay, but also on overtime. Backdated payments were also required to employees. FES may be required to pay for backdated claims and also to provide for this in the accounts. *There is a risk of misstatement of the potential liabilities in the financial statements.*	Evaluated the estimates provided by the management. Reviewed relevant guidance in relation to this area.	Management provided us with the estimates and we are satisfied with the methodology used and disclosures in the accounts.

Audit Risk	Assurance procedure	Results and conclusions
Transfer of funds between FCS and RPID (FCS) There will be an adjustment of £0.9m between the national fund in Scotland and EU funding. This is expected to be reflected in the Spring Budget revision. As a result, the billing from RPID to FCS will be reduced by the same amount. *There is a risk of expenditure misstatement*	Confirmed that transfer is included in the Spring Budget revision Examined the billing from RPID.	Our work in the area confirmed expected changes had been accounted for correctly.
SRDP grant claims (FCS) Producing and reconciling the figures of grants paid by RPID on behalf of FCS depends on the information provided by the SG. There have been delays in receiving the relevant information from the SG. *There is a risk that the grants figures in the financial statements are misstated.*	Examined the reconciliation of the figures between FCS systems and the RPID information. Reviewed IA detailed work on claims. Confirmed the figures in the accounts agree to the reconciliation.	We are satisfied with the disclosures made in the accounts in relation to SRDP grants balances.

Appendix II – Summary of local audit reports 2014/15



Appendix III – Summary of national reports 2014/15



Appendix IV – Action plan

No	Para/page	Issue/ Recommendation	Management action/response	Responsible officer	Target date
Financial audit Issues					
1	26	**Impairments identification** We note that one area of land had not been impaired due to wind damage and its lower value was therefore not reflected in the unaudited accounts. We recommend that the process of identifying and communicating to finance staff significant changes in the condition of assets that materially affect their value is formalised.	Management will review and update guidance for staff involved in land valuation and sub compartment database updates as well as finance staff.	Ross MacHardie/Donna Hutchinson	Dec 2015

No	Para/page	Issue/ Recommendation	Management action/response	Responsible officer	Target date
2	28	**Related parties disclosures** FCS and FES related party disclosures were incomplete and inaccurate in the unaudited accounts. A total of £0.8m of FCS related parties transactions had not been disclosed in the notes to the accounts. We also found that the published register of interest for FCS and FES management board members had not been updated since 24 February 2014. We recommend that the process for obtaining annual updates to the register of interests is reviewed and that consideration is given to extending this to include positive annual confirmations from all staff, in line with best practice.	FCS Senior Finance Manager will implement formal process/timetable with Corporate and Forestry Support so risk register is updated with current data.	Ross MacHardie	Oct 2015
3	33	**2015/16 FReM changes** The 2015/16 FReM has been extensively re-written and includes significant changes to the form and content of the annual report and accounts. Management should review the revised requirements to identify the impact upon their 2015/16 financial statements and to seek further opportunities for streamlining the presentation.	Senior Finance Manager will arrange for review of 2015/16 FReM and will ensure changes are incorporated into 2015/16 annual report and accounts.	Ross MacHardie	Mar 2016

No	Para/page	Issue/ Recommendation	Management action/response	Responsible officer	Target date
4	35-37	**Budget income limit** FCS has exceeded the Budget Act limit on income by £2.3m, but can accommodate the repayment of this amount due to the headroom of £2.6m budget amount "draw down but not spent", which is represented in the financial statements as a creditor with the SG. We recommend that the levels of income are monitored against the Budget Act limits.	The budget income limit will be increased in the Autumn budget review to allow more headroom for substantial grant spend/income. Management will review budget limit on an annual basis and create guidance for staff involved in this process.	Nicky Whitaker	Aug 2015
Wider audit issues					
5	40 and 46	**Financial planning** FCS and FES do not have medium or long term financial plans in place. We recommend that more detailed financial plans are produced to ensure affordability and financial sustainability of both organisations.	Plans will be produced following the outcome of the 2015/16 spending review.	Nicky Whitaker/Donna Hutchinson	2015

No	Para/page	Issue/ Recommendation	Management action/response	Responsible officer	Target date
6	59 and 70	**Trade payables control issues** We identified that for 6 out of 14 suppliers' bank details changes examined there is no record kept to evidence that these had been verified independently by checking with existing supplier contact details. We also noticed that there is no consistent approach to confirming supplier bank details.	Management will review and update guidance on this for 2015/16. Will also introduce this as a requirement for checking within Finance Support Visits.	Ross MacHardie/Donna Hutchinson	Dec 2015
		In 3 of the 30 FCS invoices sampled, the approvers exceeded their delegated authority for authorising expenditure.	These errors occurred at inception of the delegated authority policy. All staff should now be familiar with the policy and their own expenditure limits. Guidance has been published and is available on our intranet.	Ross MacHardie	Sep 2015
		FES does not have a Scheme of Delegation in place for authorising invoices. Therefore we were unable to verify whether officers authorising invoices were acting within their delegated purchasing authority.	The scheme of delegation is now within a pilot phase for all cost centres (April – June). After which feedback will be sought, a decision will be taken on how fit for purpose it was and what if any amendments are needed. Objective is to go live in summer.	Donna Hutchinson	Sep 2015