AUDIT SCOTLAND

Forestry Commission Scotland and Forest Enterprise Scotland

2015/16 Annual Audit Report to Members and the Auditor General for Scotland

July 2016

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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 (www.audit-scotland.gov.uk/about/).

Brian Howarth, Assistant Director, Audit Scotland is the appointed external auditor of **Forestry Commission Scotland and Forest Enterprise Scotland** for the period 2011/12 to 2015/16.

This report has been prepared for the use of Forestry Commission Scotland and Forest Enterprise Scotland and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in it may be used by the Auditor General in support of her wider responsibilities, including reporting to the Scottish Parliament.

Contents

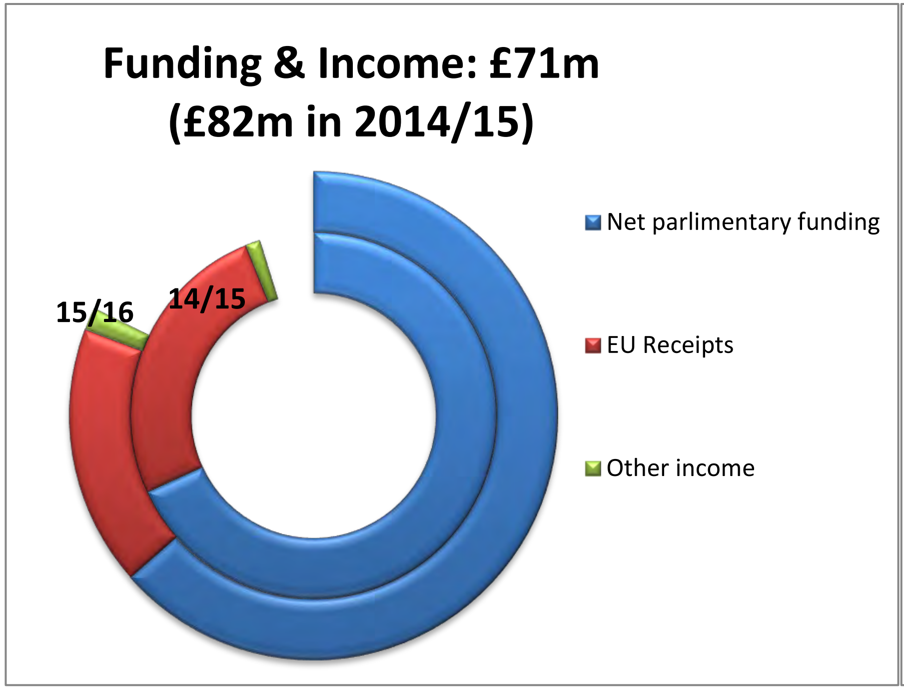
Key messages

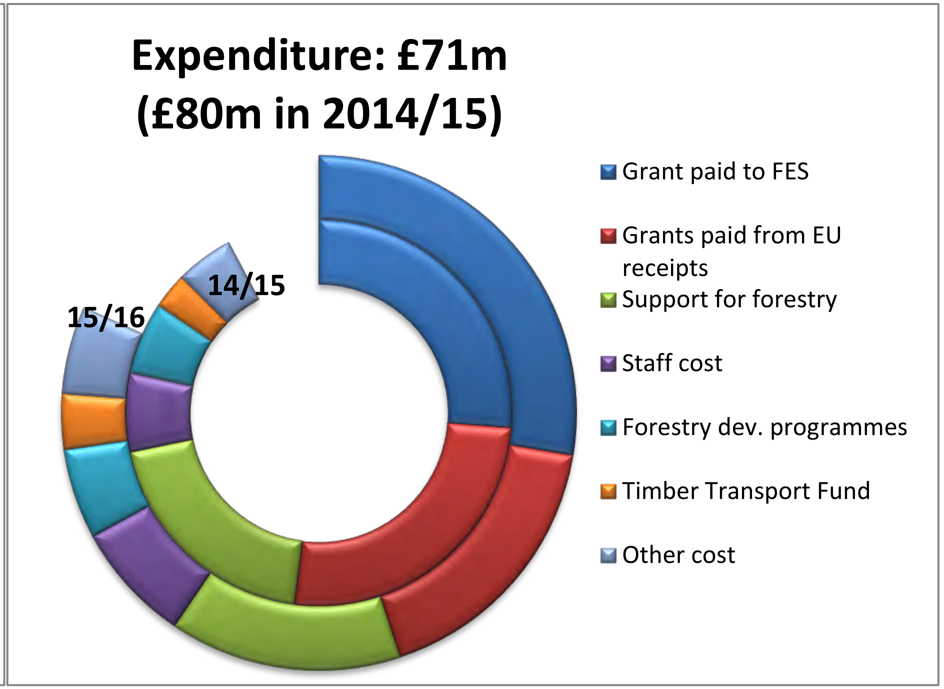
Audit of financial statements	• Unqualified independent auditor's report on the 2015/16 financial statements for FCS and FES. • The audited financial statements now reflect the budgets allocated to FCS in the Budget Act (with subsequent revisions) rather than being shown net of the savings delivered back to the Scottish Government.
Financial management and sustainability	• FCS operated within its 2015/16 Scottish Budget allocation • FES operated within resource budgets in 2015/16 • Medium and long term financial plans for FCS and FES are still to be fully developed.
Governance & accountability	• FCS and FES have effective governance arrangements. • Overall systems of internal control operated effectively during 2015/16. However, we identified a number of weaknesses in the payroll and trade payables systems.
Best Value	• There are no formal workforce plans for FCS or FES. However, a series of exercises and projects are underway to develop workforce planning.

Introduction

1. The management of FCS and FES is responsible for:
   - preparing financial statements which give a true and fair view, in accordance with the relevant financial reporting framework
   - ensuring the regularity of transactions, by putting in place systems of internal control
   - maintaining proper accounting records
   - publishing with their financial statements an annual governance statement and a remuneration and staff report.
2. Our responsibility, as the external auditor, 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.
3. 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 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.
4. Appendix I sets out the financial statements risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the 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. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". 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 them. The Audit and Risk 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. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.
9. 2015/16 is the final year of the current five year audit appointment. Audit Scotland has again been appointed as the Forestry Commission Scotland and Forest Enterprise Scotland external auditor for the next five year appointment. In accordance with agreed protocols and International Standards on Auditing we will be liaising with the incoming audit team as part of this transition.

FCS Financial Statements 2015/16

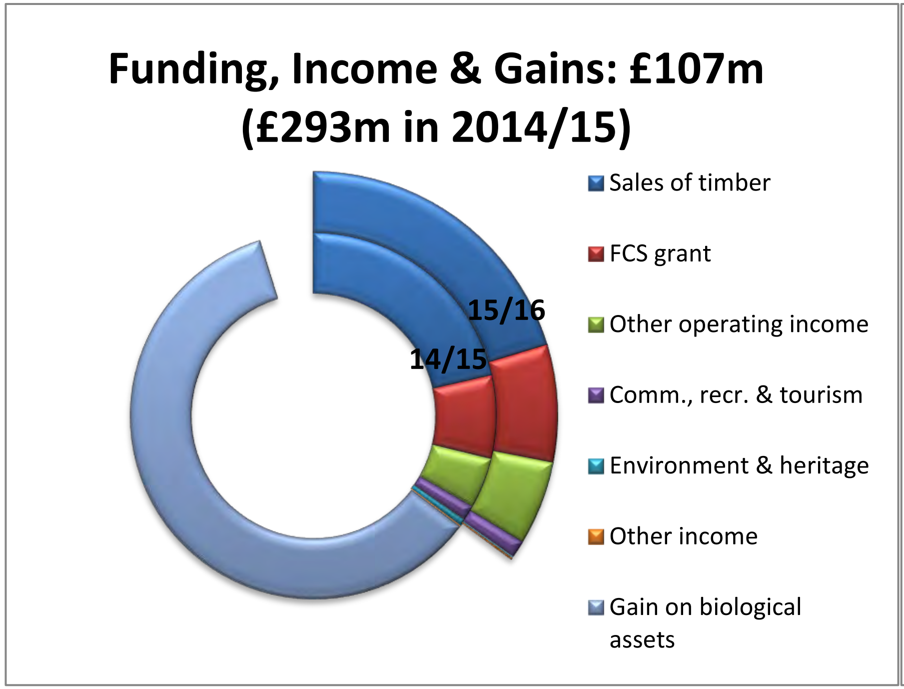


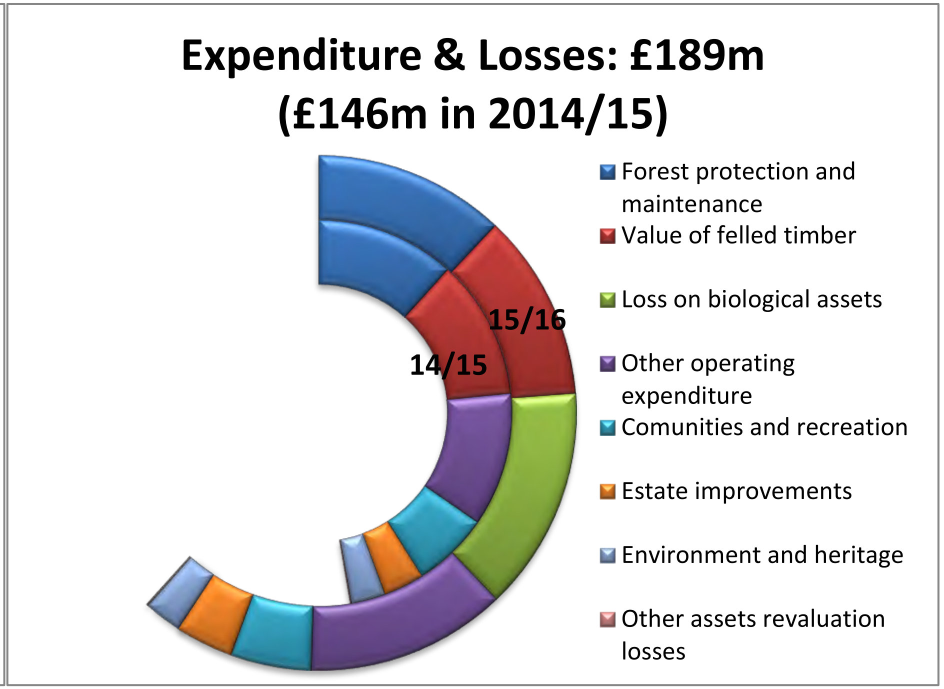


Income has decreased by £11m to £71m (14%). This reflects a reduction in EU funding of £7m and SG funding of £4m. Forestry Commission Scotland returned £6.1m to the Scottish Government (SG), after savings were requested from uncommitted expenditure in November 2015. In addition to that FCS transferred a further £2.5m to SG.

Expenditure has decreased by £9m to £71m (11%). This was mainly due to a reduction of grant payments made by FCS and financed from EU funds of £7.4m. That was a result of the decision of not committing funds to grant payments, because of the SG request mentioned above. At the same time grant paid to FES increased by £1.1m for additional funding for Peatland project.

FES Financial Statements 2015/16





Income has decreased by £186m to £107m. This is due to the change in the value of biological assets which was a gain of £184m in 2014/15 and a loss of £43m in 2015/16. There were also reductions in timber sales of £3m offset by income from renewable energy schemes and additional FCS income.

Expenditure has increased by £43m to £189m. This was due to the loss on biological assets.

Audit of the 2015/16 Financial Statements

Audit opinions

Financial Statements	• The financial statements of Forestry Commission Scotland and Forest Enterprise Scotland for 2015/16 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 2015/16 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 any 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 parts of the Remuneration & Staff Reports to be audited have been properly prepared in accordance with the Forestry Act 1967 and relevant directions. • The information given in the Performance Report of the Annual Report is consistent with the financial statements.

Submission of financial statements for audit

10. We received the unaudited financial statements on 31 May 2016 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 7 July 2016.

Overview of the scope of the audit of the financial statements

11. 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 and Risk Committee on 18 March 2016.

12. 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 2015/16 agreed fees for the audit were set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity, the fees remain unchanged.

13. 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.

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.

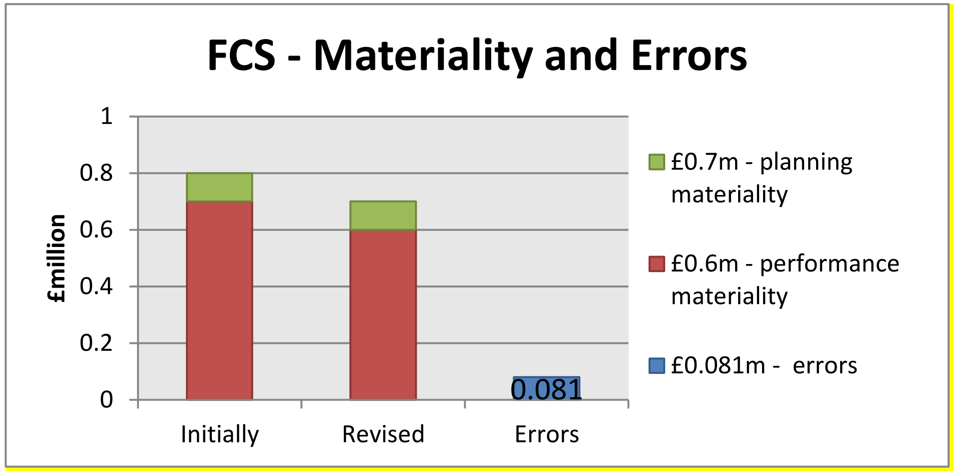
Materiality

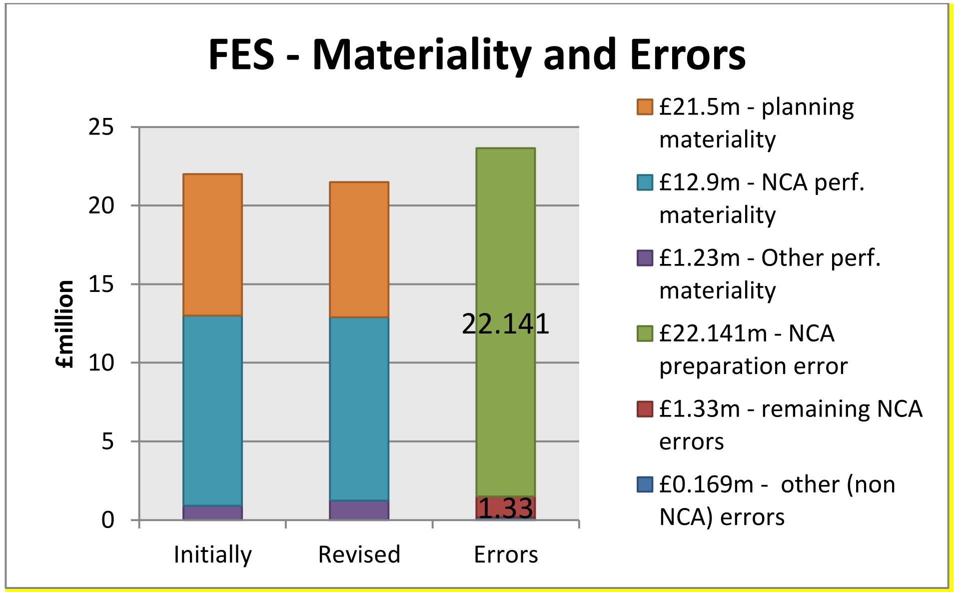
15. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. We assess the materiality of uncorrected misstatements, both individually and collectively.

16. We summarised our approach to materiality in our Annual Audit Plan. Based on the financial statements, we revised our planning materiality for 2015/16 to:

- **FCS** £0.7m (1% of gross expenditure). Performance materiality of £0.6m is determined to ensure that uncorrected and undetected audit differences do not exceed our planning materiality level.
- **FES** £21.5m (1% of total assets less liabilities/ total taxpayer's equity). Performance materiality was set at £12.9m 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 Expenditure we have set a separate performance materiality level of £1.23m.

17. We report all misstatements greater than £35,000 for FCS and FES.





Evaluation of misstatements

18. **FCS -** We have identified one misstatement above our £35,000 threshold in the FCS financial statements. Programme costs were misclassified as “other income” (£81,000). The error has been corrected in the audited financial statements.

19. **FES -** We have identified a number of errors in the unaudited accounts, totalling £23.64m. The majority of these errors related to movements in revaluation of non-current assets, with the most significant of these, £22.14m, due to a manual error in the preparation of the statements that included a transaction that wasn’t reflected in the underlying ledger or workbooks (paragraph 24) . The other main error is where revaluation reserve balances have not been eliminated correctly following asset disposals (paragraph 23). All of these issues have been corrected in the audited financial statements.

20. With the exception of the non-current assets (NCA) issues identified in FES, the errors did not breach the related performance materiality levels. As the NCA performance materiality level was exceeded, we considered the need to undertake further audit testing. However, as the vast majority of error arose from a single issue that was identified by us when comparing the unaudited financial statements to underlying records and no other issues were identified of this nature during our audit, we concluded that this is not indicative of systematic errors within the financial statements.

21. International Standard on Auditing 260 (ISA 260) requires us to communicate to you significant findings from the audit as detailed below:

- 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.

22. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260
Open Cast mines
In our 2014/15 report we explained our judgment on the contingent liability disclosure for the potential exposure to remediation costs for the forest estate sites with opencast mines. There is a possibility of FES being liable for restoration costs and this is disclosed again as a contingent liability in the 2015/16 accounts. The contingent liability disclosure remains at £17.4m. The liability costs associated with Dunston Hill (£0.7m) and Netherton (£1.7m) sites have been assessed by the appointed mineral agent, Wardell Armstrong, and remain unchanged from the 2014/15 assessment. Restoration plans for both sites have been agreed and restoration work is underway. For the two Chalmerston sites the contingent liability for 2015/16 is derived from an assessment of restoration costs (£15m) by the original operator, Scottish Resources Group, agreed under the original planning consents. This is an historic assessment and cannot be reasonably revised until such time that a new restoration strategy is approved. There is ongoing discussion between FES, the current operator Hargreaves and East Ayrshire Council on possible restoration strategies for the Chalmerston sites. We have accepted management's evaluation of the contingent liability as reasonable at 31 March 2016.

Significant findings from the audit in accordance with ISA260

Reversals of revaluation reserve

23. During our year end testing, we identified eight cases where Forest Estate and Land revaluation reserves had not been eliminated on disposal. The audit adjustment resulted in reduction in the General Fund of £1.163m and an increase to revaluation reserve of £1.128m, with the difference of £0.034m reflected in the statement of comprehensive net expenditure as an impairment. This error has been corrected in the audited financial statements.

Appendix IV - Action Plan No.1

Presentation of revaluation movements of non-current-assets

24. The FES unaudited financial statements had a manual error in the preparation of the statements that included a transaction that wasn't reflected in the underlying ledger or workbooks. The error did initially misrepresent movements in the revaluation reserve of £22.141m. This error only appeared in the draft accounts, as the working papers and the ledger were correct. This error has been corrected in the audited financial statements.

Financial commitments

25. The financial commitments disclosed in the unaudited version of the accounts were incorrect. These are commitments for contracts under the Scottish Rural Development Programmes (2014-20) agreed by FCS. The amounts disclosed were corrected in the audited financial statements from £78.9m to £62.4m.

Lease receivable restatement

26. During the audit we identified that lease receivables disclosures for FES had been significantly higher in 2015/16 (£110m) when compared to the previous year (£48.5m). We investigated the difference and were informed that the 2014/15 comparatives were incomplete as they excluded £53.3m of leases relating to a proportion of the wind and hydro schemes leases. These were not on FES recurring billing system and had been missed. The comparator has been corrected in the audited financial statements.

Future accounting and auditing developments

Code of Audit Practice

27. A new Code of Audit Practice applies to public sector audits for financial years starting on or after 1 April 2016. It replaces the Code issued in May 2011. It outlines the objectives and principles to be followed by auditors. It is part of the overall framework for the conduct of public audit in Scotland.

28. The new Code increases the transparency of our work by making more audit outputs available on Audit Scotland's website. In addition to publishing all annual audit reports, annual audit plans and other significant audit outputs will be put on the website for all audited bodies. This is irrespective of whether the body meets in public or makes documents such as audit committee papers routinely available on its own website.

29. Also, under the new Code, appointed auditors are required to provide conclusions on the four dimensions of wider-scope public audit: financial sustainability; financial management; governance and transparency; and value for money.

Public Sector Internal Auditing Standard

30. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised Public sector internal auditing standard (PSIAS). We will assess Forestry Commission Scotland and Forest Enterprise Scotland's Internal Audit against this revised standard as part of our 2016/17 audit.

FCS Financial management and sustainability

Resource Departmental Expenditure Limit (DEL) underspend £8.16m last year £2.9m underspend	+	Capital Departmental Expenditure Limit (DEL) underspend £nil last year £nil underspend	=	Total DEL Budget underspend £8.16 million last year £2.9m underspend	Total Net Assets + £0.15million
Initial Budget £62.5m		Initial Budget £1.6m		Initial Budget £64.1m	31 March 2016 -£2.25m
Final Budget £61.0m		Final Budget £1.6m		Final Budget £62.6	
Actual Outturn £52.8m		Actual Outturn £1.6m		Actual Outturn £54.4m	31 March 2015 -£2.40m
Underspend £8.2m		Underspend £nil		Underspend £8.2m	

31. The main financial objective for Forestry Commission Scotland is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers. FCS operated within the resource budgets for 2015/16 as detailed above.

32. FCS unaudited accounts showed the difference between the budget and outturn as an underspend of £0.4m. However, the budget figure used in this calculation was of £54.9m and it did not agree to the 2015/16 Spring Budget Revision Budget (SBR) figure of £62.6m. FCS's initial figure was arrived at by deducting SG savings and transfers from the SBR figure. Our view was that the initial presentation did not transparently present the financial budget and outturn accurately. The audited Statement of Parliamentary Supply in the accounts now uses the budget figures approved by the Scottish Parliament. As a result, the accounts now show a £8.2m underspend and narrative explanations were added in the annual report to explain the change.

33. The initial presentation was a result of the Scottish Government seeking savings from central government bodies in November 2015, FCS identified £6.1m of funds that had not yet been legally committed and, during the year, agreed to transfer £2.5m to the Environment and Rural Services budget within the Scottish Government.

2015/16 financial position

34. The financial statements show that Forestry Commission Scotland:

- has net liabilities of £2.25 million
- operates within its available DEL funding
- has current liabilities which exceed current assets by £2.2m.

35. There is no known change in government policy affecting the body and the budget for 2016/17 is agreed with Forestry Commission Scotland as set out in the Budget Act and spending plans.

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

37. **Going concern.** We concur with management's view that the going concern assumption remains appropriate.

2016/17 Financial Outlook

38. Forestry Commission Scotland's budget for 2016/17 is £61.3 million. This includes a Scottish Government Departmental Expenditure Revenue Limit (RDEL) for the year of £59.7 million and a budget for capital expenditure (CDEL) of £1.6 million. This is a reduction of £1.3m (2%) on 2015/16.

39. On 23 June 2016, the result of the Referendum on membership of the European Union (EU) was a majority vote to leave. In 2015/16 FCS funded £15.9m of its grant payments from EU funds (£22.3m in 2014/15). In the 2015/16 financial statements FCS has disclosed existing contractual commitments in future years of £62.4m. It is uncertain how these will be financed in the future and FCS and FES may be exposed to a risk of committed funds not being recovered.

Appendix IV - Action Plan No.2

40. We were informed by management that there is no impact of the Referendum on 2016/17 funding. The short term financial position appears robust.

Financial Planning

41. In June 2014, Audit Scotland reported on Scotland's public finances and identified that public bodies "face increasingly difficult choices in reducing spending while maintaining service standards and meeting rising demand". The report identified that financial planning improvements were required by public bodies.

42. In the local government overview report in March 2016, Audit Scotland set out some key questions, which can apply across the Scottish public sector. These questions provide a framework for our assessment of financial planning in FCS.

Assessing financial planning

How fully do our financial plans identify estimated differences between income and expenditure (budget shortfall)?

43. Financial strategies/budgets are implemented to meet FCS key objectives within available funding awards from SG. FCS has been able to amend its activity and funding of FES to meet their budget spend and has not to date identified a budget shortfall.

What options do we have to address this budget shortfall for example redesign services or use reserves? How big is the remaining funding gap after we implement our selected options? What actions are we taking to close any remaining funding gap?

44. As noted above a budget shortfall or funding gap has not been identified and specific actions to address this gap have therefore not been required.

Do we have a long-term financial strategy covering at least five years that accounts for future pressures? Is our five-year strategy supported by detailed financial plans covering a minimum period of three years? How well do our financial plans set out the implications of different levels of income spending and activity? How does our financial strategy link to our vision for the future?

45. FCS has only a high level financial plan for 2016/17. FCS informed us that they have provided scenarios to SG showing the impact of different levels of funding during previous spending reviews, but longer term financial strategies and scenario planning doesn't exist as yet.

Appendix IV - Action Plan No.3

FES Financial management and sustainability

2015/16 financial outturn

46. FES incurred a deficit of £81.8m in 2015/16 (2014/15 – surplus of £143.6m). The main reason for the deficit is a loss on revaluation of biological assets of £43m in 2015/16 compared to gain of £184.1m recorded in 2014/15 financial statements.

2015/16 financial position

47. FES net assets of £2.1bn have decreased by £0.1bn since 2014/15. This was due to the decrease in the value of biological assets, which was caused by a slowdown in the timber market and pressures from timber imports due to a stronger pound.

48. The financial statements show that Forestry Enterprise Scotland:

- has net assets of £2.1 billion
- operates with continuing deficits on operating and other activities which are not fully funded by FCS
- Has net cash outflows from operating activities (£4m)
- has an excess of current assets over current liabilities.

49. There is no known change in government policy affecting the body and the budget for 2016/17 is agreed with Forestry Commission Scotland.

2016/17 Financial Outlook

50. Forest Enterprise Scotland's budgeted income and expenditure for 2016/17 and 2017/18, shows that that net expenditure is only partly met by FCS grant.

Budget item	2016/17 (£m)	2017/18 (£m)
Expenditure	111.9	**108.7**
Income	81.2	**81.7**
Net Position	30.7	**27.0**
FCS grant	21.7	**21.7**
Variance	**9.0 ADV**	**5.3 ADV**

51. FES plans to use the cash brought forward from 2015/16 (without ring fenced funds) of £9.4m to fund the business plan variance shown above.

52. As discussed in paragraph 39 the European Union referendum result has created uncertainty around FCS and FES funding

arrangements. This could potentially impact on FES funding received from FCS

53. **Financial position and sustainability.** Subject to the realisation of income from timber sales assumptions the short term financial position appears robust.

Financial Planning

54. Similar to FCS (paragraph 42), the questions below provide a framework for our assessment of financial planning in FES.

Assessing financial planning

How fully do our financial plans identify estimated differences between income and expenditure (budget shortfall)?

55. The business plan process highlights, if applicable, where FES have budget and programme shortfall. When needed, FES adjusts the actual spend in the year to meet their budget.

56. FES has an annual business plan process which it uses to establish and agree budgets across the organisation for the next two years. As noted above (paragraph 50) there are budget shortfalls over the next two years. The 2016/17 shortfall will be met by using cash brought forward from 2015/16. The 2017/18 business plan will be balanced in the next business plan exercise. The plan is adjusted recognising gains/losses against income and further investment in programmes where possible.

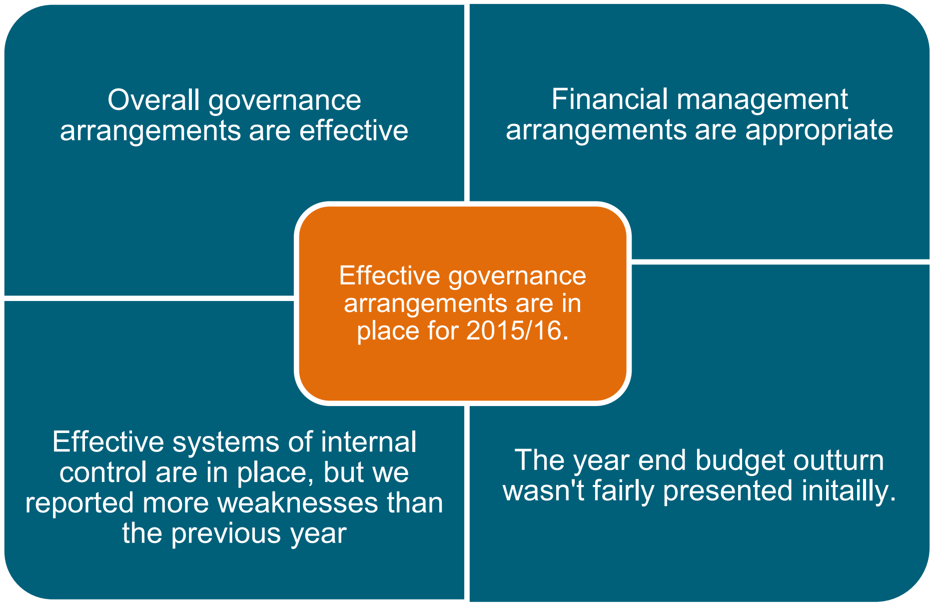
What options do we have to address this budget shortfall for example redesign services or use reserves? How big is the remaining funding gap after we implement our selected options? What actions are we taking to close any remaining funding gap?

57. FES recognised a year ago that they had a large funding shortfall in year and that was not sustainable. FES undertook a complete review of the budget and programmes and also instigated the Organisation Development Programme. The aim of the programme was to investigate significant ways to re-design how FES works to achieve long term sustainability. FES have progressed in the year since that was decided however they still have much more work to do in this area. Consultation with staff and the unions has been a key focus for the board and FES have yet to agree the prioritisation of potential changes.

In the interim period FES continues to manage their reserves into key programmes set out in the corporate plan. They also have significant resource pressures raised with Scottish Government, but as yet have not received any additional funding. Those pressures will continue to be managed within the business alongside other programme delivery.

Do we have a long-term financial strategy covering at least five years that accounts for future pressures? Is our five-year strategy supported by detailed financial plans covering a minimum period of three years? How well do our financial plans set out the implications of different levels of income spending and activity? How does our financial strategy link to our vision for the future?
58. FES does not currently have a long term financial strategy. As a starting point FES head of finance has suggested to the board an exercise to assess financial risks and undertake sensitivity analysis on those risks. **Appendix IV - Action Plan No.3**

Governance and transparency



Corporate governance

59. 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.

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

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

62. 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.

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

Financial management

64. 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 Officers have 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 significant variances.

65. Based on our accumulated knowledge, our review of Board papers and through our attendance at the committees, we conclude that FCS and FES have strong financial management arrangements in place.

Transparency

66. 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.

67. 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 and explanation of any significant movements in budget during the year.

68. 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). Forest Enterprise Scotland published its Corporate plan 2015-18.

69. 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 the public.

70. We note in paragraph 32 that the unaudited financial statements did not properly reflect the budget allocated to FCS, but instead presented a budget net of savings that were provided back to the Scottish Government. The audited financial statements have been amended to represent the FCS budget identified in the Budget Act and subsequent budget reviews.

Internal control

71. 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.

72. In our report to management in April 2016 we identified a number of issues in the payroll and trade payables systems. 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.

73. We also note that the number of issues identified during the controls testing in 2015/16 was higher than in 2014/15. This might indicate an overall weakening of the controls system in FCS and FES.

ICT audit follow-up

74. 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.

75. We note that of the ten actions identified in 2013/14, five have been fully completed, four have been partially completed and for one management decided not to take further action. We consider that the progress on these issues to be slow and we have agreed revised dates with management for the outstanding actions.

Internal Audit

76. 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.

77. As part of our risk assessment and planning process, we reviewed the internal audit function. We concluded that they operate in accordance with the Public Sector Internal Audit Standards (PSIAS). This enabled us to place reliance on the work of internal audit, in terms of their work on FCS Grants.

78. The internal audit plan for 2015/16 was substantially complete. We were able to place formal reliance on aspects of internal audit work as noted above.

Arrangements for the prevention and detection of fraud

79. 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.

80. We have examined the related parties disclosures in the financial statements and registers of interest of senior staff and non-executive members of the National Committee for Scotland. We are satisfied that the disclosures in the accounts were complete and accurate. However, because of high income and land sales transactions, we would recommend that the registers of interest should be extended to non senior staff members.

Appendix IV - Action Plan No.4

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

81. 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. We consider whether bodies have adequate arrangements in place. No issues have been identified by us for inclusion in this report.

Correspondence

82. As part of our wider Code responsibilities we are required to consider issues raised and follow these up as part of our risk based approach to the audit if they fall within our remit.

83. We received an item of correspondence from a number of the public and a Member of the Scottish Parliament raising concerns around the purchase of Rothiemurchus Forest. We had commented on this issue in a previous report and concluded that appropriate governance processes and controls were in place for the acquisition.

Best Value

Arrangements for securing Best Value

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

85. FCS and FES have in place a rolling programme of Best Value reviews to ensure continuous improvement in securing best value within both organisations. Management continuously assess best value through on-going work in areas like procurement and people management

Local performance audit reports

Workforce Planning

86. In November 2013, Audit Scotland published a report *Scotland's Public Sector Workforce.* As part of the 2015/16 audit of FCS and FES, we conducted a review of the current workforce management arrangements across the organisations as a follow-up to this report.

87. The Forestry Commission is under-going significant organisational change as a result of the decentralisation of shared services which is affecting workforce planning arrangements. Scotland currently has two main Programmes operating as a result of decentralisation which have direct staffing implications: Establishing Corporate Services Scotland (ECSS) and Organisational Development Programme (ODP). At this point in time, FCS and FES do not have formal workforce plans in place. However, during the annual cycle of business planning, each cost centre is required to consider staffing for the immediate year ahead as well as two years ahead.

88. We discussed FCS and FES current workforce management arrangements with the Head of Human Resources Scotland. Through these discussions we established that FCS and FES have been developing workforce planning arrangements through a number of exercises, projects and impact assessments. The aim of these activities has been to:

- identify succession planning activities
- establish good practice approaches to workforce planning
- recognise areas of skills gaps and training needs
- establish long term workforce planning arrangements

89. Workforce planning is at an early stage for FCS and FES and we expect work to continue into the next year to allow both bodies to take a longer-term strategic view on the workforce. In line with good practice, the bodies should develop a formal workforce plan that considers:

- good practice workforce planning approaches,
- short, medium and long term workforce requirements, including plans for succession planning,
- scenario planning, and
- employee skills gaps and training needs.

Action Point No.4

Appendix I: Significant audit risks

The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
Implementation of a new payroll system (FCS and FES) FC introduced new software for their payroll system on the 1st April 2015. Management have identified that some of the information that the new payroll system provides is incomplete. In addition to this, we have been informed that a significant number of payroll officers have left FC during the last two years. *There is a risk of material misstatement particularly around the completeness of payroll figures feeding to the ledger.*	- Performed an initial review of the system to gain understanding of the key controls and impact of the changes on payroll control environment. - Performed full controls testing to assess how well the new system is managed and provide assurance that figures produced for the financial statements are complete and accurate. - Examined the year end reconciliation between payroll and ledger.	Our controls work identified number of weaknesses; however our substantive testing during the financial statements audit did not identify any significant errors and we are satisfied that the identified weaknesses in control did not lead to any material misstatement in the accounts.

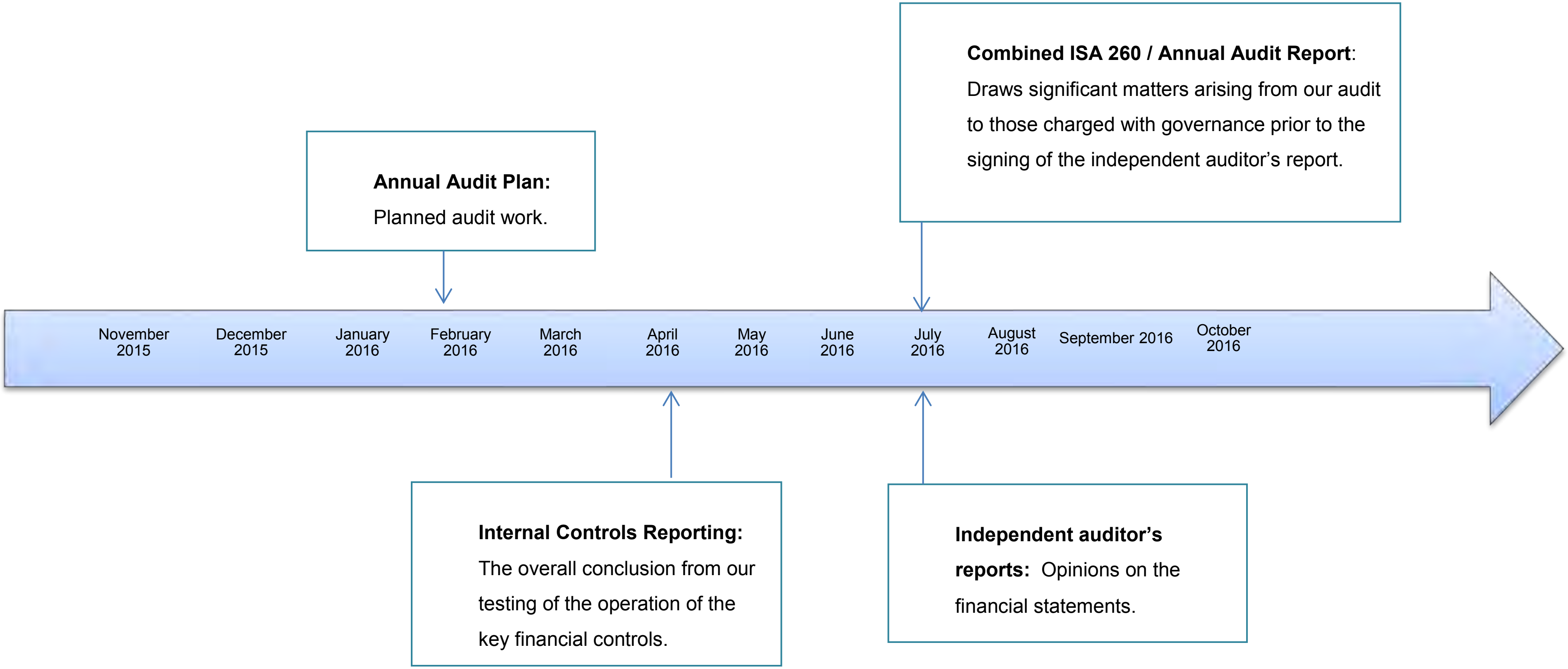
Audit Risk	Assurance procedure	Results and conclusions
Non-current assets complexity High levels of estimation and valuation are performed every year. Errors have been identified in the past as well as inconsistencies between spreadsheet and database data and with revaluation reserves. *There is a potential risk of material misstatement due to the sheer volume of data used in the calculations and manual processes involved.*	- Examined Sub Compartment Database data and compared it with the financial statements disclosures. - Examined revaluations samples with the focus on the accounting and valuation basis.	We identified a number of errors in this area, however in total these were below our performance materiality level and have been corrected by management. We are satisfied that there is no material misstatement in the accounts.
Related parties disclosures **(FCS and FES)** In the 2014/15 audit we noted that both the FCS and FES related parties disclosures were incomplete or inaccurate. We also found that the published register of interest for FCS and FES management board members had not been updated since February 2014. *There is a risk that the related parties disclosures are incomplete or inaccurate.*	- Reviewed the processes used to identify related party disclosures and updating the register of interests during our interim testing. - Assessed completeness of these disclosures based on our examination of evidence and audit knowledge during the financial statements audit.	We have examined the related parties disclosures in the financial statements and registers of interest of senior staff and non-executive members of the National Committee for Scotland. We are satisfied that the disclosures in the accounts were complete and accurate. However, because of high income and land sales transactions, we would recommend that the registers of interest should be extended to non senior staff members.

Audit Risk	Assurance procedure	Results and conclusions
Restructuring of the annual report (FCS and FES) Chapter five of the 2015/16 the FReM has been extensively re-written so 2015/16 annual accounts will need to include a performance report and accountability report. *There is a risk that the required changes are not correctly implemented.*	- Liaised with the officers during the year to discuss the required changes. - Examined the disclosures made in the unaudited financial statements and assess these against the new FReM requirements.	We have not identified any significant issues with the disclosures made in the financial statements and assess that these comply with the new FReM requirements.
Management override of controls (FCS and FES) Management have the ability to override controls. *There is an inherent risk that management manipulate accounting records and prepare fraudulent or biased financial statements by overriding controls that otherwise appear to be operating effectively.*	- Performed focused substantive testing of journal entries. - Reviewed of accounting estimates. - Evaluated any significant transactions outside the normal course of business.	Our audit work has not identified any instances of management override of controls.
HMRC liabilities (FCS and FES) HMRC is carrying out an inspection of VAT and PAYE across the Forestry Commission, including FCS and FES. HMRC work in relation to VAT under/overpayments could	- Had regular discussions with management. - Examined the accuracy, completeness of any disclosures of the provision in the 2015/16 financial statements.	Our audit work found that tax liabilities have been settled in 2015/16 and these were accounted for and we are satisfied that further liabilities are disclosed as contingent liabilities.

Audit Risk	Assurance procedure	Results and conclusions
have implications for FCS and FES disclosures and need for provisions. *There is a risk that required disclosures are not correctly classified or incomplete.*		
Opencast coal sites potential liability (FES) FES disclosed a contingent liability in its 2014/15 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.*	- Had regular discussions with management - Examined the accuracy and valuation of a disclosure in the 2015/16 financial statements.	Our audit work confirmed the completeness, accuracy and classification of the contingent liability for opencast mines restoration.
Income (FES) The majority of income (£65.8m) was received from timber sales. *The nature, 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 Dumfries and Borders forest district visit including review of timber contract management, timber despatching, invoicing procedures and timber security arrangements. - Performed substantive analytical procedures and sampling during the final accounts.	We have not identified any evidence of fraud or significant weaknesses in controls over income. Our financial statements audit has not identified significant issues and we conclude that income shown in the financial statements is materially accurate and complete.

Audit Risk	Assurance procedure	Results and conclusions
EU income (FCS) European Union income recognised in FCS accounts (£22m in 2014/15) is also recognised in consolidated SG accounts. The principal/agent relationship suggests that this approach may not be appropriate. *There is a risk that EU funding is erroneously recognised in FCS accounts.*	- Assessed the arrangements between SG and FCS around EU funding. - Liaised with TSU and SG external audit team. - Concluded on the correct treatment and discuss it with FCS management.	We have confirmed with SG auditors that EU income relating to FCS will be removed from the SG financial statements and that the continuing disclosure of this income in the FCS accounts is appropriate.
Wider dimension issues and risks		
Financial position and organisational change (FCS and FES) There are a number of significant financial and non financial risks within FCS and FES. These include: fall in timber income for FES, uncertainty over funding for FCS, lack of medium and long term financial planning, devolvement of shared services, preparation for the new procurement legislation requirements, IT back-up and disaster recovery arrangements and pre-HMRC self assessment of taxation by FCS and FES. *There is an environment of increased risk that in aggregate could have a significant impact on service delivery.*	- Discussed these issues with the management during the year. - Performed assessment of any financial plans created, especially in relation timber income shortfall and savings planned. - During the audit work we considered the IT arrangements and HMRC audit impact.	Overall the extent of risk was appropriately managed by FCS and FES, subject to development of medium and long term financial plans as noted in paragraphs 43-45 and 55-58.

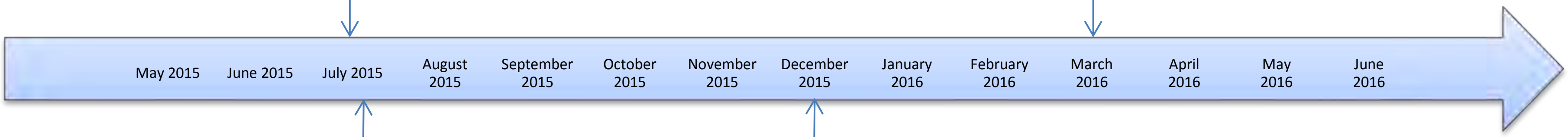
Appendix II: Summary of local audit reports



Appendix III: Summary of Audit Scotland national reports

Renewable Energy Impact Report
Follow-up of our 2013 Renewable energy report. Examined investment in renewable energy by the SG, SE and HIE renewable energy, and evaluated what has been delivered.

Managing ICT Contracts in Central Government: an Update
This reviewed the progress that the Scottish Government and central government bodies had made against the recommendations in our previous report.



Scotland's Public Sector Workforce – Impact Report
This assesses the impact made by our 2013 report, 'Scotland's public sector workforce' published on 28 November 2013 and the related good practice guide. This reviewed how the devolved public sector managed changes to its workforce to ensure that it continued to deliver service priorities, while helping bodies to deal with financial pressures and make savings.

Implementing the Scotland Act 2012: An Update
This report assessed how effectively Revenue Scotland implemented, and is collecting, the two devolved taxes introduced in April 2015. It also examined how the Scottish Government is working with HM Revenue and Customs to prepare to introduce the Scottish rate of income tax in April 2016.

Appendix IV: Action plan

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	23	**Revaluation reserve reversals** During our year end testing, we identified eight cases above the triviality threshold of £0.035m where Forest Estate and Land revaluation reserves had not been reversed upon disposal. The audit adjustment resulted in a reduction of £1.1m in the General Fund. We recommend that the controls processes around journal entries for revaluation reserve reversals is strengthened.	Current working papers and process will be amended to ensure all reserve movements incorporate the correct reserve accounting.	Ross MacHardie September 2016
2.	39	**EU funding** In 2015/16 FCS funded £15.9m of its grant payments from EU funds (£22.3m in 2014/15). In the 2015/16 financial statements FCS has disclosed commitments of £62.4m. It is uncertain how these will be financed in the future. As such FCS and FES are exposed to some liability around funds committed not being recovered We recommend that management closely monitors the financial commitments and liaise with the Scottish Government to clarify the position.	Financial commitments which include EU funding will be monitored by FCS and clear communication with Scottish Government undertaken. Management will liaise with Scottish Government to establish the future impact on budgets of potential changes in EU funding arrangements.	Nicky Whitaker Ongoing

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3.	45 and 58	**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.	Spending review budgets continue to be set on an annual basis and as FCS budget is entirely dependent on Government funding, financial planning can only be based on previous spending review settlements and potential future scenarios. This makes long term financial planning difficult, as whilst we can and do produce scenarios for SG, showing the impact of different levels of funding, high level decisions on priorities for funding and funding awards are made by SG. During 2016/17 we will be developing our approach and thinking on organisational change. Using a portfolio management approach we will be assessing our options and opportunities to drive change in the business. This will have a knock on financial effect that we will utilise to ensure that we remain financially sustainable. However, during 2016/17 we also wish to develop our long term planning capability, looking at strategic business planning, economic indicators and sensitivity analysis we will be developing a financial strategy that will guide us through the period of uncertainty.	Nicky Whitaker October 2016 (or in line with spending review) Donna Mortimer (pre March 2017)

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
4.	80	**Registers of interest** We have examined the related parties disclosures in the financial statements and registers of interest of senior staff and non-executive members of the National Committee for Scotland. We are satisfied that the disclosures in the accounts were complete and accurate. However, because of high income and land sales transactions, we would recommend that the registers of interest should be extended to non senior staff members	Management will review current processes involving non senior staff conflict of interests. Risk areas will be assessed and measures introduced or improved where necessary.	Ross MacHardie/Donna Mortimer November 2016
5.	89	**Workforce planning** We discussed FCS and FES current workforce management arrangements with management. Through these discussions we established that FCS and FES have been developing workforce planning arrangements through a number of exercises, projects and impact assessments. However, at this point in time, FCS and FES do not have formal workforce plans in place. We recommend FCS and FES develop a formal workforce plans.	A large exercise was carried out throughout 2015 to start to implement basic workforce planning across both FCS and FES. Current work focuses on succession planning for short term and medium term and change management including the Establishing Corporate Services Scotland programme. Given the current uncertainties over the future shape of the business workforce planning will continue to focus on ensuring the delivery of business as usual and the requirement to establish new services in Scotland.	Nicky Whitaker April 2017

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
			Formal workforce plans will be developed as the shape of the new organisation becomes clear.	