

# Forest Enterprise Scotland

2016/17 Annual Audit Report



 AUDIT SCOTLAND

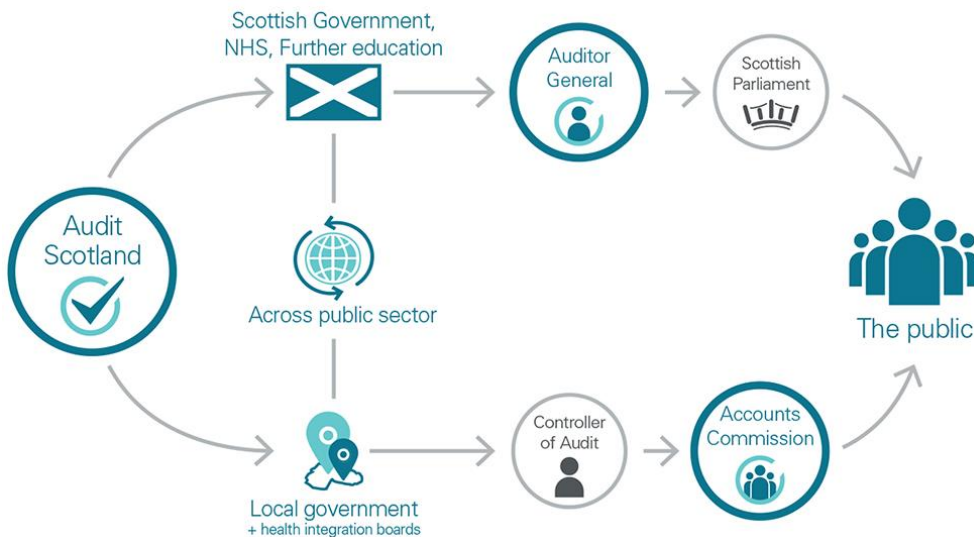
Prepared for Forest Enterprise Scotland and the Auditor General for Scotland

25 July 2017

# Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



# About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

---

# Contents

---

Key messages	4
Introduction	5
Part 1 Audit of 2016/17 financial statements	7
Part 2 Financial management	13
Part 3 Financial sustainability	16
Part 4 Governance and transparency	18
Part 5 Value for money	21
Appendix 1 Action plan 2016/17	22
Appendix 2 Significant audit risks identified during planning	24
Appendix 3 Summary of national performance reports 2016/17	27

---

# Key messages

---

## Audit of the 2016/17 financial statements

- 1 Our audit opinions were all unqualified. These covered the financial statements, regularity of transactions, remuneration and staff report, performance report and governance statement.

## Financial management

- 2 Forest Enterprise Scotland had effective arrangements in place for the financial management of the 2016/17 budget. An underspend of £14.8m was achieved resulting in increased cash balances being carried forward.
- 3 Systems of internal control operated effectively in 2016/17.

## Financial sustainability

- 4 Forest Enterprise Scotland is developing its medium to long term financial planning arrangements.
- 5 Forest Enterprise Scotland carried forward in excess of their permitted 10% cash carry-forward in 2016/17 to provide a contingency for fluctuations in future timber sales and to support future change programme expenditure. The Cabinet Secretary for the Rural Economy and Connectivity noted the increased carry forward cash balance.

## Governance and transparency

- 6 Forest Enterprise Scotland has appropriate arrangements in place to support good governance, accountability and scrutiny.
- 7 With increasing public expectations for more openness in the conduct of public business, Forest Enterprise Scotland needs to consider whether there is scope to enhance transparency in the way it conducts its business and keep this area under review.
- 8 Internal audit operates in accordance with the Public Sector Internal Audit Standards.

## Value for money

- 9 Forest Enterprise Scotland has overall arrangements in place which support effective performance management.

---

# Introduction

---

1. This report is a summary of our findings arising from the 2016/17 audit of Forest Enterprise Scotland.

2. The scope of our audit was set out in our Annual Audit Plan presented to the March 2017 meeting of the Audit and Risk Committee. This report comprises:

- an audit of the annual report and accounts
- consideration of the wider dimensions set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

---

## Exhibit 1

### Audit dimensions



Source: Code of Audit Practice 2016

---

3. The main elements of our audit work in 2016/17 have been:

- an interim audit of Forest Enterprise Scotland's main financial systems and governance arrangements
- an audit of Forest Enterprise Scotland's 2016/17 annual report and accounts including the issue of an independent auditor's report setting out our opinion.

4. Forest Enterprise Scotland is responsible for preparing financial statements that give a true and fair view, for the accuracy of the other information in the annual reports and accounts, and for establishing effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

- 5.** Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), supplementary guidance and, guided by the auditing profession's ethical guidance.
- 6.** These responsibilities include giving an independent opinion on the financial statements, regularity, the remuneration and staff report, the performance report and the governance statement. We also review and report on the arrangements within Forest Enterprise Scotland to manage their performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.
- 7.** Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.
- 8.** The weaknesses or risks identified in this report are only those that have come to our attention during our normal audit work, and may not be all that exist. Also, our annual audit report contains an action plan at [Appendix 1 \(page 22\)](#). It sets out specific recommendations, responsible officers and dates for implementation.
- 9.** Communication in this report of matters arising from the audit of the annual report and accounts or of risks or of weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.
- 10.** As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee for the audit was set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.
- 11.** This report is addressed to both the board and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).
- 12.** We would like to thank all management and staff who have been involved in our work for their cooperation and assistance during the audit.

# Part 1

## Audit of 2016/17 financial statements



### Main judgements

**Our audit opinions were all unqualified. These covered the financial statements, regularity of transactions, remuneration and staff report, performance report and governance statement.**

#### Unqualified audit opinions

**13.** The annual reports and accounts for the year ended 31 March 2107 were approved by the Audit and Risk Committee on 21 July 2017. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements
- an unqualified opinion on regularity of expenditure and income and
- an unqualified audit opinion on the remuneration and staff report, performance report and governance statement.

**14.** Additionally, we are satisfied that there are no matters which we are required by the Auditor General to report by exception.

The annual report and accounts are the principal means of accounting for the stewardship of resources and performance in the use of those resources.

#### Submission of annual report and accounts for audit

**15.** We received the unaudited financial statements on 31 May 2017, in line with our agreed audit timetable.

**16.** The working papers provided with the unaudited financial statements were generally of a good standard and finance staff provided excellent support to the audit team which helped ensure the final accounts audit process concluded in accordance with the agreed timescale. We have agreed to hold a 'lessons learned' meeting with management in order to discuss some alternative approaches to the preparation and provision of working papers in order to improve the process for preparing next year's accounts.

#### Risk of material misstatement

**17.** [Appendix 2 \(page 24\)](#) provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of resources to the audit and directing the efforts of the audit team.

#### Materiality

**18.** Materiality defines the maximum error that we are prepared to accept and still conclude that our audit objective has been achieved. The assessment of what is

material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

**19.** Our initial assessment of materiality for the annual reports and accounts was undertaken during the planning phase of the audit. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

**20.** On receipt of the annual reports and accounts we reviewed our original materiality calculations and updated these to reflect the reported outturn at 31 March 2017. This is summarised in [Exhibit 2](#).

## Exhibit 2

### Materiality values

FES Materiality level	Amount
<b>Overall materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of total assets less total liabilities for the year ended 31 March 2017.	£21.3 million
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality:	
<ul style="list-style-type: none"> <li>for biological assets, forest estate and land, the performance materiality level is 60% of planning materiality</li> </ul>	£12.8m
<ul style="list-style-type: none"> <li>for the Statement of Comprehensive Net Expenditure and the rest of the Statement of Financial Position items, the performance materiality level is 65% of 1% of net expenditure (£10.9 million)</li> </ul>	£0.07m
<b>Reporting threshold</b> – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 5% of overall materiality (net expenditure).	£5,000

Source: Audit Scotland

## Evaluation of misstatements

**21.** There were a number of material adjustments to the unaudited financial statements arising both from our audit and management's review of the accounts. These included:

- management identified an issue in relation to the double counting of non-current assets held for sale (£2m) and an error of £0.6m in relation to income accrued
- the audit review identified misstatements in relation to windfarm valuations (£0.2m), accrued income (£0.03m) and assets under construction wrongly categorised (£0.06m).

**22.** With the exception of the misstatement related to the incorrect classification of an asset under construction, all misstatements, both presentational and monetary, were adjusted and revised accordingly. The unadjusted misstatement refers to an asset (£0.06m) which was completed during the year but was not notified to



finance staff until after the year end. As a consequence, the asset should have been moved to operational assets and depreciation charged as appropriate.

**23.** It is our responsibility to request that all misstatements are corrected although the final decision on this lies with those charged with governance taking into account advice from senior officer and materiality levels. Management do not propose to adjust for the item above as the amounts are not considered material in the context of the financial statements. We agree that these amounts are immaterial.

**24.** There were a number of amendments processed to the accounts during the audit. Net operating expenditure increased by £0.7m and total taxpayer's equity decreased by the same amount. The misstatements breached the related performance materiality levels and as a consequence we considered the need to undertake further audit testing. As the majority of misstatements arose from single isolated issues and no other similar issues were identified during our audit, we concluded that this is not indicative of systemic misstatements within the financial statements.

### Significant findings from the audit

**25.** International Standard on Auditing (UK and Ireland) 260 requires us to communicate significant findings from the audit to you. These are summarised in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1 \(page 22\)](#) has been included.

## Exhibit 3

### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Governance statement</b></p> <p>The governance statement records that the accountable officer receives assurances through a wide range of governance arrangements. For example, written assurances are received from the Director Central Services for the Forestry Commission. The accountable officer receives further assurances from the management team through their regular reports and updates. However there are no formal assurance arrangements in place for the management team to provide their view of the control system applying throughout the financial year.</p> <p>The Scottish Public Finance Manual (SPFM) notes that in order to enable the accountable officer to sign the governance statement, assurances are required on the maintenance and review of the whole range of internal control systems, many of which will be directly managed by other senior officers. The SPFM refers to a checklist and assurance certificate.</p> <p>We have therefore recommended to management that to assist the accountable officer fulfil his responsibilities, specific assurances should be sought from senior staff in the organisation.</p>	<p>Management has agreed to review the process for collating the assurances from Management Board members going forward.</p> <p><a href="#">Action Plan (Appendix 1, point 1)</a></p>

Issue	Resolution
<p><b>2. Assessment of fair value: vehicles</b></p> <p>The financial statements record vehicles and machinery held at 31 March 2017 of £8.4m.</p> <p>During 2016/17, management assessed that the revaluation method applied, comparing to a market value, was inappropriate. We agreed with management's view that by adapting the vehicles for forestry use made a market comparison difficult to assess.</p> <p>Under IFRS 13 where there is an absence of reliable market based information upon which a fair value can be generated, an alternative approach can be applied. The approach applied is the 'cost approach' which reflects the amount that would be required currently to replace the service capacity of an asset.</p> <p>This change in approach has led to a reduction in the depreciation charge for the year (£0.8m) and a decrease in asset values (£1.2m). We have reviewed the revised figures and consider that they are reasonable.</p> <p>The assets have been assessed at fair value using the knowledge and professional expertise of staff within Forest Enterprise Scotland. There has been no independent assessment of the value of the vehicles.</p>	<p>We have requested and received written assurances from the accountable officer that the processes in place are suitable to provide an accurate assessment of the fair value of the vehicles held at 31 March 2017.</p> <p>We have reviewed the evidence provided to support the valuation and agree that the process adopted provides a reasonable assessment of the fair value of vehicles held at 31 March 2017.</p>
<p><b>3. Forest estate and biological assets</b></p> <p>The accounts record forest estate assets of £915m and biological assets of £901m. The valuation of these assets is based on a random sample of assets (between 8-10%) and which are subject to a five yearly external professional valuation. The last revaluation was undertaken at 31 March 2013.</p> <p>In between these formal valuations, the valuer provides custom indices which are applied by Forest Enterprise Scotland staff to restate land values.</p>	<p>We have requested and received written assurances from the accountable officer that the methodology applied provides a reasonable assessment of the fair value of the forest estate and biological assets as at 31 March 2017.</p> <p>We have reviewed the evidence provided to support the valuation and agree that the process adopted provides a reasonable assessment of the fair value at 31 March 2017</p>
<p><b>4. Cash and cash equivalents</b></p> <p>The framework agreement between the Scottish Government and Forest Enterprise Scotland states that unspent cash balances may be accumulated to a maximum of 10% of turnover. The annual accounts record cash balances of £31.5m which is in excess of this limit.</p> <p>Agreement was sought and received from the Cabinet Secretary for the Rural Economy and Connectivity with regard to the holding of cash balances in excess of that permitted by the framework agreement.</p>	<p>The Cabinet Secretary for the Rural Economy and Connectivity noted the increased cash balance.</p> <p>The revised framework agreement which takes effect from 2017/18 reflects an increase in the level of cash carry forward permitted.</p>

Issue	Resolution
<p><b>5. Contingent liabilities: open cast coal sites</b></p> <p>Note 19 of the financial statements refers to contingent liabilities of around £17.4m in relation to the potential exposure to remediation costs for the forest estate opencast coal sites. We have reported in previous years about the possibility of Forest Enterprise Scotland being liable for restoration costs and this is disclosed again as a contingent liability in the 2016/17 accounts.</p> <p>The contingent liability disclosure remains unchanged at £17.4m. Officers have advised that there has been no change to the previously reported assessment of liability. Forest Enterprise Scotland is part of a partnership arrangement and as a consequence have no direct control over the timing of remediation works. Progress is being made in the Dunston Hill site which is anticipated to conclude in 2017/18. The remaining sites remain under on-going review and discussion with all parties involved. The largest site is at Chalmerston (£14.9m). Management have advised that while some progress is being made to agree for example a restoration plan, the mineral agents have provided a view that there is no change to the estimated liability at 31 March 2017.</p> <p>We have asked management to confirm that all known liabilities have been fully and properly disclosed in the 2016/17 financial statements.</p>	<p>The accountable officer has provided assurances, that based on the expert advice provided by the mineral agents, all known liabilities have been fully and properly disclosed.</p> <p>We have accepted management's evaluation of the contingent liability as reasonable at 31 March 2017.</p>
<p><b>6. Contingent liabilities: HMRC tax audit</b></p> <p>Note 19 (contingent liabilities) refers to an on-going review by HMRC of Forest Enterprise Scotland's treatment of VAT and income tax. The liability has been classified as unquantifiable at this stage as the review progresses. We are aware that as part of the retained cash balance, £2.5m has been earmarked as a potential payment. Management continue to monitor the situation.</p>	<p>Management have provided assurances that until the review concludes, they are unable to quantify any potential amount due.</p> <p>We have accepted management's evaluation of the contingent liability as reasonable at 31 March 2017.</p>
<p><b>7. Material errors</b></p> <p>Two material accounting errors were identified by Forest Enterprise Scotland staff following the submission of the accounts to audit. A £2m adjustment was required to correct an asset held for sale which was posted twice and the other referred to an error in the volume of sales entered into the Sales Recording Package system (£0.6m). As noted above, the accounts were amended to reflect correction of these errors. We are pleased to note that internal checks identified these errors. Management should review the underlying reasons behind the occurrence of these errors.</p>	<p>Management has agreed to investigate the reasons behind these errors and introduce procedures to ensure no similar instances can occur going forward. <a href="#">Action Plan (Appendix 1, point 2)</a></p>

## Other findings

**26.** We have highlighted below a number of other matters identified during our audit.

### Bad debt provision

**27.** The 2016/17 financial statements disclose current trade and other receivables of £20.1m of which £14.4m refer to accounts receivables. £0.94m refers to debt in excess of 90 days overdue. A bad debt provision of £0.27m has been set off against the total debt outstanding. We have been advised by management that each debt is assessed individually and a view taken of the recoverability of the debt. While we agree with this approach generally, we have discussed with management that as part of the review of finance functions, they should review the procedures for debt collection and related provision. There is a risk that the actual collection of debt may fall short of that assumed. [Action Plan \(Appendix 1, point 3\)](#)

### Exit packages

**28.** No exit packages have been disclosed in the 2016/17 annual accounts. We are aware that 10 shared service staff left the organisation on an early exit package during 2016/17 as part of the devolution of forestry programme. The costs were split between England and Scotland. Forestry Commission Scotland bore the entire Scottish element of the cost, with no costs attributed to Forest Enterprise Scotland. There is no formal agreement to this although management has advised that all parties agreed to this treatment and the Scottish Government were also informed. We have recommended that decisions of this type should be formally recorded going forwards. [Action Plan \(Appendix 1, point 4\)](#)

### Cash and cash equivalents

**29.** As noted above the statement of financial position discloses a cash balance of £31.5m. The increase, from £19.7m in 2015/16, reflects an increase in income generating activities. A further £1.8 was provided by Forest Enterprise Scotland towards the transition process. Forest Enterprise Scotland is permitted to carry forward cash reserves in order to smooth out trading income cycles and maintain consistent investment in key programmes. The strategy includes the building up of carry forward reserves during periods when the timber market is strong. In addition, Forest Enterprise Scotland intends to build up cash reserves to fund the completion of forestry devolution.

**30.** The cash balance has been reviewed by management and earmarked for specific uses going forwards. These include:

- £2.5m is ring fenced. £1.7m is earmarked as a bond for opencast restoration and £0.8m is awaiting a private sector investment decision
- £7.1m from land sales has been earmarked to sustain woodland creation activity
- £2.3m has been set aside for the completion of programmes affected by weather or other short-term delays
- £19.6m accumulated trading surplus. Of this £11.2m has been allocated into the 2017/18 Business Plan
- £4.2m preparation for forestry devolution and £4.5m to cover previously deferred silviculture and civil engineering programmes and fleet investments
- £2.5m VAT reserve (awaiting final settlement with HMRC)
- The remaining £8.4m is for carry forward for future cost of forestry devolution and mitigation against fluctuations in trading income.

# Part 2

## Financial management



### Main judgements

Forest Enterprise Scotland had effective arrangements in place for the financial management of the 2016/17 budget. An underspend of £14.8m was achieved resulting in increased cash balances being carried forward.

Systems of internal control operated effectively in 2016/17.

### Financial performance in 2016/17

31. The main financial objective for Forest Enterprise Scotland is to ensure that the financial outturn for the year operated within its agreed budget in 2016/17.

32. Forest Enterprise Scotland has reported net operating expenditure of £15.5m, remaining within its overall budget for 2016/17 with an underspend of £14.8m recorded against budget. The financial performance is shown in [Exhibit 4](#).

### Exhibit 4

#### Financial performance

Financial performance	2016/17 budget £m	Actual outturn £m	Overspend/ (underspend) £m
Total managed expenditure	107.0	103.4	(3.6)
Total managed income	76.6	87.9	(11.3)
<b>Net operating expenditure</b>	<b>30.4</b>	<b>15.5</b>	<b>(14.9)</b>
FCS contribution: revenue	20.1	20.1	-
FCS grant: capital	1.6	1.6	-

Source: Forest Enterprise Scotland budget report 2016/17; 2016/17 annual report and accounts

## Internal controls

**33.** As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant for the production of the financial statements. Our objective is to gain assurance that the organisation has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**34.** Our findings were included in an interim audit report presented to the Audit and Risk Committee in July 2017. We concluded that the controls were operating effectively, with the exception of a small number of issues relating to payroll validation, authorisation of journals, change in supplier bank account details, ICT data validation and non current asset disposals.

**35.** We developed further audit procedures to gain assurance in response to these findings. We are pleased to report that management has agreed to take appropriate action to address the matters raised.

**36.** No significant internal control weaknesses were identified during the audit which could affect Forest Enterprise Scotland's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

## Budgetary processes

**37.** We also reviewed Forest Enterprise Scotland's budgetary processes and budget monitoring arrangements. From our review of budget monitoring reports, review of committee papers and meetings with senior finance staff we confirmed that senior management and members receive regular, timely and up to date financial information on the financial position.

**38.** We concluded that Forest Enterprise Scotland has effective budgetary monitoring and control arrangements that allow both non-executive directors and management to carry out effective scrutiny of its finances.

## Prevention and detection of fraud and irregularity

**39.** We assessed Forest Enterprise Scotland's arrangements for the prevention and detection of fraud. Our audit work covered a number of areas such as whistleblowing and review of the counter fraud strategy.

**40.** The Forestry Commission's Fraud Policy Statement was updated in May 2017. This was published by the Forestry Commission's shared services, Finance and Accountancy Services and applies to both Forestry Commission Scotland and Forest Enterprise Scotland.

**41.** We concluded that Forest Enterprise Scotland are proactive in promoting fraud awareness and had appropriate and adequate arrangements in place for fraud detection and prevention during 2016/17.

## National Fraud Initiative

**42.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or error ([Exhibit 5](#)). The results of the joint NFI exercise for Forest Enterprise Scotland and Forestry Commission Scotland are shown below.

---

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

---

## Exhibit 5

Total number of matches



1,248

Number recommended for investigation



237

Completed/closed investigations



289

Source: FCS Senior Finance Manager

**43.** The National Fraud Initiative in Scotland report was issued in June 2016. A self appraisal checklist was included and all participants were encouraged to review the checklist to ensure that they were fully informed of the planning and the progress being made by their officers investigating the NFI 2016/17 exercise. The checklist was not completed by management.

**44.** The Senior Finance Manager within Forestry Commission Scotland is responsible for reviewing NFI matches. As part of the 2016/17 NFI exercise, 1,248 matches were identified for both Forestry Commission Scotland and Forest Enterprise Scotland, of which 237 were high quality matches. We are pleased to record that all high quality matches relating to possible duplicate payments have been reviewed. This sample was extended to cover additional items of interest. The Senior Finance Manager now intends to continue the review into payroll and VAT high quality matches. No frauds have been identified to date.

**45.** The Audit and Risk Committee were advised of the 2016/17 NFI exercise in November 2016. An update of progress was provided to the July 2017 meeting.

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

**46.** We have reviewed the arrangements in place to maintain standards of conduct including the Staff Handbook, HR Policy and register of interests. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

**47.** Based on our review of the evidence we concluded that Forest Enterprise Scotland has appropriate arrangements in place for the prevention and detection of bribery corruption. We are not aware of any specific issues that we need to bring to your attention.



# Part 3

## Financial sustainability



### Main judgements

**Forest Enterprise Scotland is developing its medium to long term financial planning arrangements.**

**Forest Enterprise Scotland carried forward in excess of their permitted 10% cash carry-forward in 2016/17 to provide a contingency for fluctuations in future timber sales and to support future change programme expenditure. The Cabinet Secretary for the Rural Economy and Connectivity noted the increased carry forward cash balance.**

### 2016/17 financial position

**48.** The Statement of Financial Position summarises what is owned and owed by Forest Enterprise Scotland. This shows taxpayers' equity – an accounting measurement of the amount invested that has continuing public benefit. It shows how much of this has arisen from the application of revenues and that which has resulted through changes over time in the value of physical assets.

**49.** The financial statements show that Forest Enterprise Scotland has net assets of £2.1bn, a decrease of £16m largely attributable to a decrease in the value of biological assets (£20.7m), a decrease in non-current assets (£9.0m) offset by an increase in cash held (£11.8m).

**50.** The increase in the cash balance (£11.8m) reflects increased timber sales and careful management of expenditure. Forest Enterprise Scotland are permitted to carry forward cash resources into the following year to cover ring fenced projects, land sales for reinvestment, short term programming and a trading surplus of up to 15% of turnover. The amount carried forward as a trading surplus exceeded that permitted and as a consequence, agreement to carry forward this increased balance was requested and received from the Cabinet Secretary for the Rural Economy and Connectivity.

### Financial planning

**51.** Forest Enterprise Scotland's budgeted net expenditure for 2017/18, excluding the Forestry Commission Scotland contribution, is £27.3m. This is a reduction in budgeted net expenditure of £3.1m from 2016/17. Forestry Commission Scotland's contribution has reduced to £20.7m for 2017/18 (£21.7m) resulting in an overall budgeted net expenditure position of £6.6m for 2017/18.

**52.** Forest Enterprise Scotland's expenditure is only partly met by Forestry Commission Scotland grant (approximately 20%) and the remaining income comes from their trading activities. Forest Enterprise Scotland also receives capital funding for forest sales funds, land acquisitions, woodland creation and provision of starter farms.

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.



**53.** Fluctuations in timber income and costs pressures continue to have an impact on the financial sustainability of Forest Enterprise Scotland but as mentioned previously, cash balances are being managed to offset these fluctuations.

### Medium to long term financial planning

**54.** We reviewed the financial planning systems and assessed how effective they are in identifying and addressing risks to financial sustainability across the medium and long term.

**55.** We are pleased to note that Forest Enterprise Scotland is in the process of developing a Financial Strategy and Long-Term Finance Plan 2017-2027. The draft strategy consists of five key operating principles:

- moving to an asset based approach, from a programme based approach
- diversifying
- sustaining and smoothing income
- securing best value from delivering budgets
- reducing running costs
- optimising operating infrastructure.

**56.** In order to implement this strategy, each of the key assets: forest blocks; estate leases; and major recreation facilities require to be clearly identified. It is recognised that a move towards this approach involves considerable work and an action plan has been developed to enable the transition. The impact of organisational change programmes will also impact on this process.

**57.** The draft strategy was presented to the Forestry Commission's National Committee for Scotland in June 2017 and an update on progress will be provided at the November meeting.

**58.** It is intended that the financial strategy will form part of Forest Enterprise Scotland's operating framework which will include a workforce plan, procurement strategy; ICT strategy; Build Asset Management Plan and National Spatial Plan. [Action Plan \(Appendix 1, point 5\)](#)

**59.** The Forestry and Land Management (Scotland) Bill will replace the Forestry Act 1967 and a new executive agency, Forestry and Land Scotland will be created. This includes the management of the National Forest Estate by Scottish Ministers, which involves a wider land management role, not just forestry. This revised financial strategy will take account of these changes.

**60.** A joint Forest Enterprise Scotland/ Forestry Commission Scotland Procurement Strategy for 2017/18 was published in December 2016. The strategy has been designed to support delivery of the Corporate Plan's aims and objectives and aims to ensure compliance with procurement legislation and guidance.

# Part 4

## Governance and transparency



### Main judgements

**Forest Enterprise Scotland has appropriate arrangements in place to support good governance, accountability and scrutiny.**

**With increasing public expectations for more openness in the conduct of public business, Forest Enterprise Scotland needs to consider whether there is scope to enhance transparency in the way it conducts its business and keep this area under review.**

**Internal audit operates in accordance with the Public Sector Internal Audit Standards.**

### Governance arrangements

**61.** As part of the wider review of governance arrangements across the public sector, we completed a follow-up of our 'Role of Boards' national report, published in September 2010. The involved review of documentation, reliance on the work of internal audit and discussions with key officers.

**62.** The governance structure is complex reflecting the current cross border arrangements for the management of the forest estate. The Forestry Commission has a chair and a board of commissioners who are responsible for stewardship of the UK national forest estate. Certain duties have been delegated to the National Committee for Scotland by the commissioners. The National Committee was established to help formulate advice to Ministers on the strategic direction of forestry in Scotland and to help ensure that the Minister's policies are carried out efficiently and effectively.

**63.** The National Committee for Scotland includes representation from the Forestry commissioners (2 non-executives and 1 executive director), senior Forestry Commission Scotland and Forest Enterprise Scotland staff and a further three non-executive committee members.

**64.** The Scotland Executive Board was established in 2016/17 with membership drawn from Forest Enterprise Scotland and Forestry Commission Scotland management boards. The board was established to address the organisational change programme and devolution of the Forestry Commission. ([see para 69 below](#))

**65.** The Forest Enterprise Scotland Management Board is the senior management monitoring and decision making forum. It is well established, with members demonstrating commitment to their roles and responsibilities. Internal audit noted that Forest Enterprise England has a non-executive member on their management board and have recommended that Forest Enterprise Scotland adopt the same approach.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.

**66.** The governance arrangements in place support effective working relationships between senior management, chief officers, non-executives and commissioners.

**67.** 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. The Audit and Risk Committee works across both Forestry Commission Scotland and Forest Enterprise Scotland. From attendance at these meetings we can confirm that the Audit and Risk Committee effectively holds officers to account.

**68.** There are a number of organisational change programmes underway which will have a direct impact on Forest Enterprise Scotland and its governance structures. These include:

- Following on from the Scottish Government's consultation on full devolution of Forestry Commission services, the Forestry and Land Management (Scotland) Bill was published in May 2017. The intention is to create a new executive agency of the Scottish Ministers from the existing Forest Enterprise Scotland. This will also lead to the wind up of the cross border arrangement currently in place.
- A number of services are shared across all the forestry bodies. A programme is underway to devolve these services to member countries.

**69.** Forest Enterprise Scotland and the Forestry Commission Scotland maintain their own risk registers which are overseen by the Audit and Risk Committee. We concluded that, overall, Forest Enterprise Scotland has appropriate arrangements in place that support good governance, accountability and scrutiny.

## The annual governance statement

**70.** Under the Treasury's Financial Reporting Manual (FRoM), Forest Enterprise Scotland must prepare an annual governance statement within the Annual Report and Accounts. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the statement and provides assurances around the achievement of the organisation's strategic objectives.

**71.** The SPFM does not prescribe a format for the annual governance statement, but sets out minimum requirements for central government bodies. The process undertaken by management included conducting an assurance mapping exercise and working to an assurance plan that assessed the evidence underpinning the preparation of the governance statement.

**72.** As noted previously, there are no formal assurance arrangements in place for the management team to provide their view of the control system applying throughout the financial year. We have therefore recommended to management that to assist the accountable officer fulfil his responsibilities, specific assurances should be sought from senior staff in the organisation.

**73.** We can conclude that the 2016/17 annual governance statement complies with the guidance issued by the Scottish Ministers. Based on our knowledge and work performed it presents a comprehensive picture of governance arrangements.

## Internal audit

**74.** Internal audit provides the accountable officer with independent assurance on Forestry Enterprise Scotland's overall risk management, internal control and corporate governance processes.

**75.** The Head of Internal Audit gave an overall opinion that the control framework continues to provide substantial assurance that material risks to the achievement of the full range of objectives are identified and adequately managed.

**76.** Internal audit was provided by an in-house internal audit department during 2016/17. We carried out a review of the adequacy of the internal audit function and concluded that it operated in accordance with the Public Sector Internal Audit Standards and has sound documentation standards and reporting procedures in place. The in-house service was disbanded in March 2017 as a result of the devolution of Forestry Commission shared services. The Scottish Government Internal Audit Department took over the provision of internal audit services from April 2017.

**77.** To avoid duplication effort we place reliance on the work of internal audit wherever possible. In 2016/17 we placed formal reliance on internal audit's work on Payroll Implementation. We also considered internal audit report findings, in particular their work on the Role of Boards, as part of our wider dimension work.

## ICT risks

**78.** We carried out an ICT overview on the Forestry Commission's shared Information Systems function to confirm the design and working of general ICT controls. In addition, we looked at the controls in place for the Sales Recording Package. We reported on specific issues in our interim report.

**79.** We were able to conclude that the general ICT controls in place are working as expected. We also recognised that at this stage in the transition programme, any improvements will be taken forward by the new Scottish IT function. We are pleased to report that the IT systems security patching was kept up-to-date and that the data communication network was not affected by the cyber attack which many private and public sector bodies experienced in May 2017.

## Risk management

**80.** We reviewed Forest Enterprise Scotland's risk management arrangements. Forest Enterprise Scotland has a risk management policy and has both functional and agency risk registers. Risk registers are reviewed on a regular basis and subject to discussion by the management board. Regularly updates on the key and emerging risks are provided to the Audit and Risk Committee.

**81.** We concluded that risk management arrangements in place are appropriate.

## Transparency

**82.** Transparency means that stakeholders, including the public, have access to understandable, relevant and timely information about how Forest Enterprise Scotland is taking decisions and how it is using resources.

**83.** The minutes of a range of meetings are publicly available on Forest Enterprise Scotland's website. These include the National Committee for Scotland, the Scotland Executive Board and the Forest Enterprise Management Board. Some of the background papers are also available. Audit and Risk Committee minutes and papers are not publically available.

**84.** With increasing public expectations for more openness in the conduct of public business, Forest Enterprise Scotland needs to consider whether there is scope to enhance transparency in the way it conducts its business and keep this area under review.

# Part 5

## Value for money



### Main judgements

**Forest Enterprise Scotland has overall arrangements in place which support effective performance management.**

#### Performance management

**85.** Value for money is a key element of our audit approach. In 2016/17, the first year of our audit appointment, we did not identify any significant value for money risks during our planning and therefore did not undertake any specific value for money work this year. We will keep this area under review over the five-year audit appointment and will report as appropriate.

**86.** Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value. Where such requirements are not specified we may, in conjunction with Forest Enterprise Scotland agree to undertake local work in this area.

**87.** Key Forest Enterprise Scotland targets are set by the Forestry Commission National Committee for Scotland on an annual basis. Corporate commitments are split into six themes with the key priorities measured and monitored throughout the year using a performance dashboard. Progress and activity is monitored by the National Committee and the Forest Enterprise Scotland Management Board.

**88.** Performance against each of these targets is reported in Forest Enterprise Scotland's 2016/17 Annual Report and Accounts and we are pleased to record that all targets have been met.

**89.** We concluded that Forest Enterprise Scotland has overall arrangements in place which support the achievement of effective performance management.

#### National performance audit reports

**90.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2016/16, we published a number of reports which are of direct interest to the board. These are outlined in [Appendix 3](#) accompanying this report.

Value for money is concerned with using resources effectively and continually improving services.

# Appendix 1

## Action plan 2016/17

### 2016/17 recommendations for improvement

Page no.	Issue/risk	Recommendation	Agreed management action/timing
9	<p><b>1. Governance statement</b></p> <p>The accountable officer receives assurances through a wide range of governance arrangements. There are no formal assurance arrangements in place for the management team to provide their view of the control system applying throughout the financial year.</p> <p>There is a risk that the accountable officer is unable to provide an unqualified view on the range of controls in place across the organisation.</p>	<p>The accountable officer should request specific written assurances on the range of internal control systems directly managed by senior officers.</p>	<p>Formal assurance process will be reviewed to identify any inconsistencies with SPFM guidance. Appropriate measures will be put in place to comply with recommended assurance framework.</p> <p>Responsible officer: Fiona Wood/Donna Mortimer</p> <p>Agreed date: December 2017</p>
11	<p><b>2. Material errors</b></p> <p>Two material errors were identified by Forest Enterprise Scotland staff following the submission of the accounts to audit.</p> <p>There is a risk that material errors may be undetected resulting in a misstatement of the accounts.</p>	<p>Management should review the underlying causes of these errors to ensure no recurrence going forwards.</p>	<p>A formal review will be undertaken on both occurrences. Appropriate improvements will be put in place.</p> <p>Responsible officer: Fiona Wood/Donna Mortimer</p> <p>Agreed date: December 2017</p>
12	<p><b>3. Bad debt provision</b></p> <p>Debt collection procedures should be reviewed.</p> <p>There is a risk that the collection of debt falls short of that assumed.</p>	<p>Management should review procedures for providing for potential bad debts.</p>	<p>A review will be undertaken of both timber and non timber debt as part of the devolution of central services. Appropriate improvements will be put in place.</p> <p>Responsible officer: Fiona Wood/Donna Mortimer</p> <p>Agreed date: December 2018 due to the fact that devolution is not due to be live until April 2018</p>



Page no.	Issue/risk	Recommendation	Agreed management action/timing
12	<p><b>4. Exit packages</b></p> <p>Forestry Commission Scotland funded the full cost of exit packages in respect of shared service staff. There was no evidence of this being formally agreed between Forest Enterprise and Forestry Commission Scotland.</p> <p>There is a risk that expenditure is incurred without the appropriate agreement.</p>	<p>Funding decisions should be formally recorded as evidence of the discussions and subsequent agreement.</p>	<p>Formal records for internal funding decisions of this nature will be retained by FES.</p> <p>Responsible officer: Donna Mortimer</p> <p>Agreed date: Immediate</p>
17	<p><b>5. Financial planning</b></p> <p>Forest Enterprise Scotland is currently developing a finance strategy and long term finance plan.</p> <p>Until these are fully developed, there is a risk that, the organisation cannot ensure its affordability and financial sustainability.</p>	<p>We recommend that the planning process continue to be developed.</p> <p>Plans should set out scenario plans with a much clearer assessment of the impact of budget assumptions on activity and any residual risks.</p>	<p>Work will be ongoing to develop the strategy further including the action plan. A long term plan will be developed and will include scenario planning, impact and risk.</p> <p>Responsible officer: Donna Mortimer</p> <p>Agreed date: December 2017</p>



# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit Risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> <li>• Detailed testing of journal entries.</li> <li>• Review of accounting estimates.</li> <li>• Focussed testing of accruals and prepayments.</li> <li>• Evaluation of significant transactions that are outside the normal course of business.</li> <li>• Substantive testing of transactions after the year end to confirm expenditure and income have been accounted for in the correct financial year.</li> </ul>	<p>We did not identify any issues as a result of our audit work that would indicate management override of controls affecting the year end position.</p> <p>We reported matters arising in our interim report relating to instances where some journals had been input and authorised by the same officer. We recommended that, for controls to be effective, there should be clear segregation of duties. Journals should be subject to independent review and authorisation.</p>
<p><b>2 Risk of fraud over income</b></p> <p>ISA240 requires auditors to presume a risk of fraud where income streams, other than Scottish Government funding, are significant.</p> <p>In 2015/16, excluding grant funding from FCS, FES received income in excess of £83.5m from other sources, including £62m from timber sales. The nature, extent complexity and geographical dispersion of income sources means that, in accordance with ISA240, there is an inherent risk of fraud.</p>	<ul style="list-style-type: none"> <li>• Analytical procedures on income streams.</li> <li>• Controls testing during the Galloway forest district visit, including review of timber contract management, timber despatching, invoicing procedures, income controls and timber security arrangements.</li> <li>• Detailed testing of revenue transactions focusing on the areas of greatest risk.</li> </ul>	<p>Analytical procedures did not identify any unexpected variances.</p> <p>Our controls testing did not identify any issues with Forest Enterprise Scotland's revenue recognition procedures.</p> <p>We substantively tested a sample of income transactions; no issues were identified.</p>



Audit Risk	Assurance procedure	Results and conclusions
<p><b>3 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of non current assets, contingent liabilities and provisions.</p> <p>For example, in 2015/16 biological assets of £191m were valued based on a random sample of assets the results of which are extrapolated across the whole estate.</p> <p>A contingent liability of £17.4m was disclosed in the 2015/16 financial statements in relation to opencast coal sites. The liability is subject to ongoing review.</p> <p>Discussions continue with HMRC in relation to a potential VAT liability.</p>	<ul style="list-style-type: none"> <li>• Review the work of an expert for the professional valuer (wind farms/hydro, and forest estate/biological assets)</li> <li>• Review accounting policies to ensure they are reasonable.</li> <li>• Substantive review of revaluation reserve adjustments, taking into account any changes in the accounting policies.</li> <li>• Regular discussions with management on the opencast coal sites potential liability. We will also examine the accuracy and valuation of the disclosures in the financial statements.</li> <li>• Focussed substantive testing of year end balances.</li> </ul>	<p>We reviewed the work of the professional valuers and no issues were identified.</p> <p>Review of accounting policies revealed they are reasonable.</p> <p>No issues with our review of the revaluation reserve.</p> <p>Updates on the opencast coal sites and HMRC potential liabilities took place during 2016/17 and we are satisfied with the disclosures in the financial statements.</p> <p>Undertook focussed substantive testing of year end balances and no issues were identified.</p>

### Risks identified from the auditor's wider responsibility under the Code of Audit Practice





















<p><b>4 Financial management and financial sustainability</b></p> <p>In June 2014, Audit Scotland reported on Scotland's Public Finances and identified that financial planning improvements were required by public bodies. We are aware that:</p> <ul style="list-style-type: none"> <li>• FES does not have medium or long term financial plans in place.</li> <li>• FES is susceptible to income fluctuations, particularly in relation to timber sales.</li> <li>• FCS may be impacted by the outcome of Scottish Government spending reviews.</li> </ul>	<ul style="list-style-type: none"> <li>• Monitor progress on medium to long-term financial planning.</li> <li>• Monitoring of quarterly finance reports.</li> <li>• Ledger interrogation through the use of IDEA.</li> <li>• Place reliance on Internal Audit's review of EU grant schemes and payments.</li> <li>• Review action taken in respect of NFI matches.</li> <li>• Undertake performance audit work on European funding.</li> </ul>	<p>See <a href="#">parts 2 &amp; 3</a> of this report.</p>
<p><b>5 Governance and Transparency</b></p> <p>There are a number of significant ongoing organisational change programmes:</p> <ul style="list-style-type: none"> <li>• Forestry Governance</li> </ul>	<ul style="list-style-type: none"> <li>• Follow up on any outstanding matters raised in relation to recording related party disclosures in the register of interests.</li> <li>• Follow up to our 2010 Role of Boards Report.</li> <li>• Monitor the Scottish</li> </ul>	<p>Refer to <a href="#">Part 4</a> of this report.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>Programme: this project is looking at cross border functions including Forest Research and the Future of Forestry in Scotland and also includes consideration of the different roles of FCS.</p> <ul style="list-style-type: none"> <li>• Establishing Corporate Services Scotland: this programme is reviewing the transition of shared services from FC Central Services into FC Scotland. In particular, the Forestry Commission (GB-wide) currently has an in-house internal audit service. From April 2017, internal audit for Scotland will be provided by the Scottish Government's Internal Audit Division.</li> <li>• Future of Forestry in Scotland: the Scottish Government's consultation on full-devolution of Forestry Commission services ended in November 2016 with an announcement on the future of FCS and FES expected in March 2017.</li> </ul> <p>While the full devolution of services will better suit Scotland's forestry needs and will link the relationship between policy and spend, the scale and range of these programmes could have an impact on staff morale and turnover. There could be a loss of key staff and knowledge due to the uncertainty. Internal controls may not be as effective in a period of change. There is also a risk that the organisation cannot continue to provide key services alongside managing the change programmes</p>	<p>Government's Review of the future of Forestry in Scotland and consider the impact on the organisation.</p> <ul style="list-style-type: none"> <li>• Early review of Internal Audit work and early discussion on any material issues arising.</li> <li>• Review progress on workforce planning.</li> <li>• Monitor progress on testing plans for business continuity.</li> </ul>	

# Appendix 3

## Summary of national performance reports 2016/17



Apr			
May		Common Agricultural Policy Futures programme: an update	
Jun		South Ayrshire Council: Best Value audit report	 The National Fraud Initiative in Scotland
Jul		Audit of higher education in Scottish universities	 Supporting Scotland's economic growth
Aug		Maintaining Scotland's roads: a follow-up report	 Superfast broadband for Scotland: a progress update
			 Scotland's colleges 2016
Sept		Social work in Scotland	 Scotland's new financial powers
Oct		Angus Council: Best Value audit report	 NHS in Scotland 2016
Nov		How councils work – Roles and working relationships in councils	 Local government in Scotland: Financial overview 2015/16
Dec		Falkirk Council: Best Value audit report	 East Dunbartonshire Council: Best Value audit report
Jan			
Feb		Scotland's NHS workforce	
Mar		Local government in Scotland: Performance and challenges 2017	 i6: a review
			 Managing new financial powers: an update

### The following reports may be of particular interest:

[Common Agricultural Policy Futures programme: an update](#) – May 2016

[The National Fraud Initiative in Scotland](#) – June 2016

[Scotland's new financial powers](#) – September 2016

# Forest Enterprise Scotland

## 2016/17 Annual Audit Report

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0131 625 1500 or [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)

For the latest news, reports and updates, follow us on:



Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
T: 0131 625 1500 E: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)