

Forestry Commission Scotland

2016/17 Annual Audit Report



 AUDIT SCOTLAND

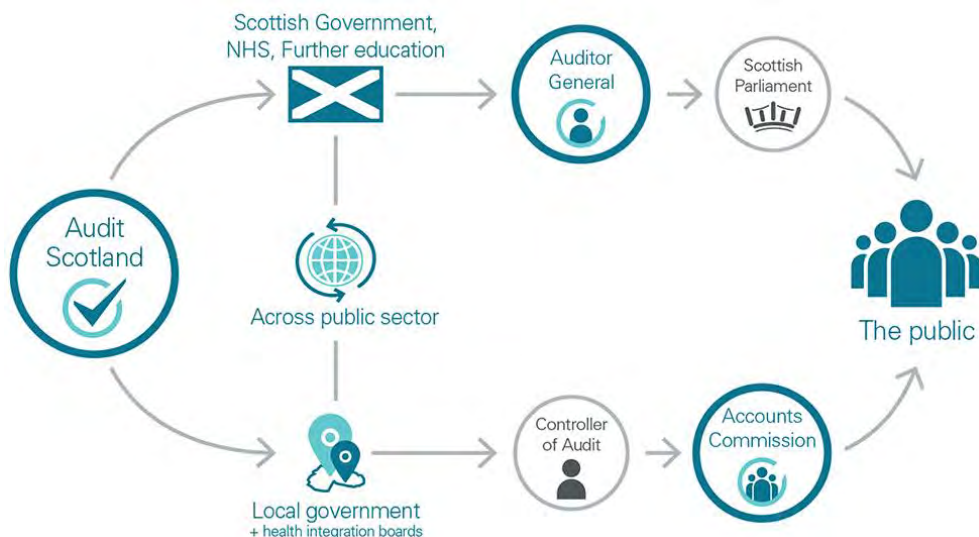
Prepared for Forestry Commission Scotland and the Auditor General for Scotland

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.

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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 Forestry Commission Scotland has effective arrangements in place for financial management and has remained within its overall resource budget for 2016/17.
- 3 An underspend of £3.2m was achieved, of which £1.0m was planned on behalf of the Scottish Government to return Timber Transport Funding which did not achieve the demand originally anticipated.
- 4 Systems of internal control operated effectively in 2016/17.

Financial sustainability

- 5 Forestry Commission Scotland has adequate financial planning arrangements for the year ahead based on their annual business plan.
- 6 The development of longer term financial planning has been deferred due to the introduction of the Forestry and Land Management (Scotland) Bill which is expected to result in the transfer of Forestry Commission Scotland responsibilities to the Scottish Government.

Governance and transparency

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

Value for money

- 10 Forestry Commission 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 Forestry Commission 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 reports 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 Forestry Commission Scotland's main financial systems and governance arrangements
- an audit of Forestry Commission Scotland's 2016/17 annual report and accounts including the issue of our independent auditor's report setting out our opinions.

4. Forestry Commission 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 independent opinions 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 Forestry Commission 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 \(page 21\)](#). 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 any 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.
- 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 report 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 its resources and its performance in the use of those resources.

Submission of annual report and accounts for audit

15. We received the unaudited financial statements on 30 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 was completed in accordance with the required 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 \(page 23\)](#) 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 report 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

FCS Materiality level	Amount
Overall materiality – 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 gross expenditure for the year ended 31 March 2017.	£0.716 million
Performance materiality – 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 at 85% of overall materiality.	£0.609 million
Reporting threshold – 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.	£35,000

Source: Audit Scotland

Evaluation of misstatements

21. A number of presentational and monetary adjustments to the accounts were identified during the course of our audit. These were discussed with senior finance officers who agreed to amend the financial statements. There are no unadjusted misstatements. The total of all misstatements was below our performance materiality level and we concluded that no further audit procedures were required.

Significant findings from the audit

22. 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 \(page 21\)](#) has been included.

Exhibit 3

Significant findings from the audit of financial statements

Issue	Resolution
<p>1. Governance statement</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 her 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>Action Plan (Appendix 1, point 1)</p>
<p>2. Annually managed expenditure - overspend</p> <p>The annual accounts disclose an overspend of annually managed expenditure (AME) of £85,000 against the level permitted by Scottish Government. The overspend was as a direct result of Forestry Commission Scotland bearing the full cost of redundancies related to the restructuring of forestry services.</p>	<p>The Scottish Government confirmed retrospectively that the AME overspend was managed within the overall AME budget for the Scottish administration.</p> <p>Aggregate expenditure was within the total limit set by the Budget Act.</p>
<p>3. Exit packages</p> <p>A number of shared service staff left the organisation on an early exit package during 2016/17 as part of Forestry Commission devolution. 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.</p>	<p>Management have confirmed that although there was no formal agreement, both parties had agreed to the arrangement and the Scottish Government were kept apprised of the arrangement. This formed part of the change programme.</p> <p>Action Plan (Appendix 1, point 2)</p>

Other findings

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

EU funding

24. The 2016/17 financial statements disclose current trade and other receivables of £16.1m of which £15.4m relates to the accrual of income from the European Union (EU). £11.7m was accrued in 2015/16. The accrual represents committed grant funding due to be received in respect of projects related to the creation of woodland. All forestry payments are made by the Scottish Government's Rural Payments and Inspections Division (RPID), who are the accredited paying agency in Scotland for all European Commission Common Agricultural Policy (CAP) grants. Trades Payables reflect the payment of these grants to third parties.

25. Note 18 of the financial statements (other financial commitments) reflect the extent of the future funding liabilities of Forestry Commission Scotland under the various European programmes. These total £76.3m and include:

- Scottish Rural Development Plan 2007-2013 (woodland creation and replanting): £33.9m
- Scottish Rural Development Plan 2014-2020 (woodland creation and replanting): £33.1m
- Scottish Rural Development Plan 2007-2013 (existing woodlands): £3.2m
- Scottish Rural Development Plan 2014-2020 (existing woodlands): £6.1m

26. Forestry Commission Scotland has responsibility for the monitoring and compliance with EU regulations. To ensure compliance with the regulations, internal audit and finance staff have reviewed the procedures and processes in place. The Head of Internal Audit, in her Annual Report noted no significant matters arising. We have been advised that there may be a disallowance penalty relating to 2016/17 but this is estimated to be not material. Discussions are ongoing to assess the level of any repayment. There remains a risk that some further scheme funding may be disallowed going forward if EU funding requirements and regulations are not adhered to. [Action Plan \(Appendix 1, point 3\)](#)

Cash and cash equivalents

27. The statement of financial position discloses a cash balance of £12.8m, an increase of £6.4m from 2015/16. The increase reflects funding drawn down in respect of the locally funded element of the EU funded projects mentioned above which have not yet been paid. In addition £1.7m excess cash is to be repaid to the Scottish Government.

Part 2

Financial management



Main judgements

Forestry Commission Scotland has arrangements in place for effective financial management and has remained within its overall resource budget for 2016/17.

An underspend of £3.2m was achieved, of which £1.0m was planned on behalf of the Scottish Government to return Timber Transport Funding which did not achieve the demand originally anticipated.

Systems of internal control operated effectively in 2016/17.

Financial performance in 2016/17

28. 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.

29. Forestry Commission Scotland has reported net operating expenditure of £54.2m, remaining within its overall budget for 2016/17 with an underspend of £3.2m. This included an element of capital DEL which was allocated to Forest Enterprise Scotland (FES). The financial performance against Departmental Expenditure Limits (DEL) and the AME budget is shown in [Exhibit 4](#).

Exhibit 4

Performance against budget in 2016/17

Performance	Initial budget £m	Final budget £m	Actual outturn £m	Overspend/ (underspend) £m
Resource DEL	59.7	55.7	52.4	(3.3)
Capital DEL (FES)	1.6	1.6	1.6	-
Total DEL	61.3	57.3	54.0	(3.3)
Annually Managed Expenditure (AME)	-	0.1	0.2	0.1
Total Allocation	61.3	57.4	54.2	3.2

Source: Forestry Commission Scotland's Annual Report and Accounts 2016/17

30. A number of adjustments were made to the original budget. £3.8m was deducted as part of the Scottish Government's spring budget revision and £0.1m was provided as annually managed expenditure. It was also agreed with the Scottish Government that a further £1.0m resource DEL was to be returned although no adjustment was made to the budget. The return of the further £1.0m related to Timber Transport Funding which did not achieve the demand originally anticipated. The total resource budget adjustment managed by Forestry Commission Scotland during 2016/17 was £4.7m. This was achieved largely by the rescheduling of uncommitted grants and deferring other planned expenditure.

31. Funding for Forestry Commission Scotland includes a subsidy agreed by the Scottish Government for Forest Enterprise Scotland who manages the forest estate. In addition to the £21.7m DEL provided, a further £1.8m was transferred to help fund future transition costs relating to the further devolution of services and impact of the forestry review.

32. The underspend arose as a result of funds that have been set aside for organisational change which were not incurred and a contingency for potential liability payments in relation to the HMRC tax audit. The results of the HMRC audit will not be known until late 2017.

33. As previously mentioned, Forestry Commission Scotland overspent their AME budget by £0.085m; the Scottish Government confirmed retrospectively that the AME overspend was managed within the overall Scottish AME budget. This overspend occurred as a result of Forestry Commission Scotland bearing the full cost of 10 exit packages (£0.2m). These exit packages arose as a result of the decentralisation of shared services and Internal Audit being provided by the Scottish Government Internal Audit Service. Staff who did not have roles in the new structure in Forestry Commission England and Forestry Commission Scotland and no suitable alternative posts were found for them were made redundant.

34. The Statement of Financial Position at 31 March 2017 shows net liabilities of £2.2m (2015/16: net liabilities of £2.3m). This negative position has arisen as a result of the forest asset estate transferring to Forest Enterprise Scotland in 2012/13. This was undertaken in order to align the asset accounting with timber income and expenditure which is recorded by Forest Enterprise Scotland who have responsibility for managing the forestry estate.

Internal controls

35. 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 Forestry Commission Scotland has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

36. 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 regarding payroll validation, authorisation of journals, change in supplier bank details and ICT data validation.

37. 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.

38. No significant internal control weaknesses were identified during the audit which could affect Forestry Commission 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.

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

Budgetary processes

39. We also reviewed Forestry Commission 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 non-executive directors receive regular, timely and up to date financial information on the financial position.

40. We concluded that Forestry Commission 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

41. We assessed Forestry Commission 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.

42. 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.

43. We concluded that Forestry Commission 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

44. 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 figures noted below reflect the matches applicable to both Forestry Commission Scotland and Forest Enterprise Scotland.

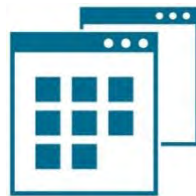
Exhibit 5

Total number of matches



1,248

Number recommended for investigation



237

Completed/closed investigations



289

Source: Forestry Commission Scotland

45. The National Fraud Initiative in Scotland report was issued in June 2016. A self appraisal checklist was included at Appendix 2 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.

46. The Senior Finance Manager 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.

47. 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

48. 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.

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

Part 3

Financial Sustainability



Main judgements

Forestry Commission Scotland has adequate financial planning arrangements for the year ahead based on their annual business plan.

The development of longer term financial planning has been deferred due to the introduction of the Forestry and Land Management (Scotland) Bill which is expected to result in the transfer of Forestry Commission Scotland responsibilities to the Scottish Government.

2016/17 financial position

50. The Statement of Financial Position summarises what is owned and owed by Forestry Commission 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.

51. The financial statements show that Forestry Commission Scotland has net liabilities of £2.1 million which is a decrease of £0.04 million when compared to 2015/16. This is largely attributable to the disposal of IT assets. This is not considered an issue in relation to the going concern of the organisation as FCS receives all its funding directly from the Scottish Government.

Financial planning

52. Forestry Commission Scotland's draft budget for 2017/18 was set at £61.3m, which is the same as the original 2016/17 budget. The budget comprises a resource allocation of £59.7m and an indirect capital allocation of £1.6m allocation. The capital budget is transferred to Forest Enterprise Scotland. This budget was agreed with the Scottish Government through the spending review process.

53. The budget includes an increase in woodland grants funding in recognition of the national performance targets together with an offsetting decrease in programme costs. The subsidy payment to Forest Enterprise Scotland has reduced from £21.7m in 2016/17 to £20.7m in 2017/18. The 2017/18 budget continues to show a challenging position, reflecting the impact of financial pressures.

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. Forestry Commission Scotland does not have any longer term financial plans in place. Our 2015/16 annual report recommended that more detailed financial plans are produced to ensure the affordability and financial sustainability of the organisation. We recognise that in the absence of a recent multi-year spending

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.

review, budgets continue to be set on an annual basis and the budget is entirely dependent on Government funding. We are also aware of the Scottish Government's review of the future of forestry which has resulted in the Forestry and Land Management (Scotland) Bill. This is expected to result in the transfer of Forestry Commission Scotland responsibilities to the Scottish Government.

56. We accept that this review has caused uncertainty and understand the difficulties in longer term planning at this time. Following the conclusion of the Bill and agreement as to the way forward for Forestry Commission Scotland as a division of the Scottish Government, we have discussed with management the need for a longer-term financial strategy to be prepared.

57. 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

Forestry Commission 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, Forestry Commission 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

58. 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. This involved review of documentation, reliance on the work of internal audit and discussions with key officers.

59. 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.

60. 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.

61. 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 65 below](#))

62. The Forestry Commission Management Board is the senior management monitoring and decision making forum. It is well established, with members demonstrating commitment to their roles and responsibilities.

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

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.

64. 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.

65. There are a number of organisational change programmes underway which will have a direct impact on Forestry Commission 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 Bill seeks to repeal the Forestry Act 1967 and is expected to result in the transfer of Forestry Commission Scotland responsibilities to the Scottish Government;
- a number of services are shared across all the forestry bodies. A programme is underway to devolve these services to the member countries.

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

The annual governance statement

67. Under the Treasury's Financial Reporting Manual (FRM), Forestry Commission 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.

68. 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.

69. 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 her responsibilities, specific assurances should be sought from senior staff in the organisation.

70. We concluded 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 and matters.

Internal audit

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

72. 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.

73. 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.

74. To avoid duplication of effort we place reliance on the work of internal audit wherever possible. In 2016/17 we planned to place formal reliance on internal audit's work on Payroll Implementation and grant payments. While the payroll review was completed to allow us to rely on this work, only a part year review was undertaken of grant payments. We therefore undertook some additional testing to ensure coverage of the whole year. 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

75. We carried out a high level overview on the Forestry Commission's shared Information Systems function to confirm the design and working of general ICT controls. We reported on a number of issues in our interim report.

76. 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

77. We reviewed Forestry Commission Scotland's risk management arrangements. Forestry Commission Scotland has a risk management policy and risk registers which 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.

78. We have concluded that risk management arrangements in place are appropriate.

Transparency

79. Transparency means that stakeholders, including the public, have access to understandable, relevant and timely information about how Forestry Commission Scotland is taking decisions and how it is using resources.

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

81. With increasing public expectations for more openness in the conduct of public business, Forestry Commission 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

Forestry Commission Scotland has overall arrangements in place which support effective performance management.

Performance management

82. 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.

83. 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 Forestry Commission Scotland agree to undertake local work in this area.

84. The National Committee agrees Forestry Commission Scotland's priorities on an annual basis in agreement with the Head of Forestry Commission Scotland. Eight priorities were identified at the National Committee meeting in June 2016. Progress and activity is monitored by National Committee.

85. Performance against each of these priorities is reported in Forestry Commission Scotland's 2016/17 Annual Report and Accounts and good progress has been made in relation to all the priorities.

86. The Mackinnon report was published in December 2016. This report was commissioned to identify opportunities for simplifying and speeding up the Forestry Grant Scheme approval process for woodland creation. The report made 21 recommendations that have been condensed into six work streams which have been taken forward by a joint stakeholder Delivery Group.

87. We concluded that Forestry Commission Scotland has overall arrangements in place which support the achievement of effective performance management.

National performance audit reports

88. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2016/17, we published a number of reports which are of direct interest to members. 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>1. Governance statement</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: Ross MacHardie/Nicky Whitaker</p> <p>Agreed date: December 2017</p>
9	<p>2. Exit packages</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 Forestry Commission and Forest Enterprise 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 documented in FCS budget folders. Senior Finance Manager will review on a monthly basis to ensure sufficient records are in place.</p> <p>Responsible officer: Ross MacHardie</p> <p>Agreed date: Immediate</p>
10	<p>3. EU funding</p> <p>The financial statements disclose existing EU contractual commitments in future years of £76.3m. There remains a risk that some scheme funding may be disallowed resulting in subsequent pressures on finances.</p>	<p>Officers should ensure that all EU funding requirements and regulations are adhered to.</p>	<p>FCS Grants & Regulations team have updated guidance and procedures to ensure compliance with EU regulations. Training and support has also been provided to ensure understanding is embedded across the organisation.</p> <p>Head of Delivery & Regions has liaises closely with</p>



Page no. **Issue/risk**



Recommendation



Agreed management action/timing

SGRIPD so they can input their expertise and confirm that FCS procedures are satisfactory.

FCS also has control of the new Forestry Grant Scheme design and is able to respond quickly where concerns or issues come to light in order to reduce risk of disallowance. In recognition of greater responsibility FCS has restructured the Grants & regulations team to increase capacity for scheme management and assurance processes.

Responsible officer: Brendan Callaghan

Agreed date: Ongoing

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
Risks of material misstatement in the financial statements		
<p>1 Risk of management override of controls</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"> • Detailed testing of journal entries. • Review of accounting estimates. • Focussed testing of accruals and prepayments. • Evaluation of significant transactions that are outside the normal course of business. • Substantive testing of transactions after the year end to confirm expenditure and income have been accounted for in the correct financial year. 	<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>2 Risk of fraud over expenditure</p> <p>ISA240 and the Code of Audit Practice require auditors to consider the risk of fraud over certain types of public sector expenditure. This includes grants and other claims made by individuals and organisations on the public purse. Examples of grants provided by FCS include grants paid to private woodland owners from EU receipts and other general support grants paid. There is a risk that grants are not paid appropriately.</p>	<ul style="list-style-type: none"> • Detailed testing of revenue transactions focusing on the areas of greatest risk. 	<p>We substantively tested a sample of expenditure items: no issues were identified.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>3 EU Funded grant schemes</p> <p>Matrix information received from the Scottish Government's Rural Payments and Inspection Division (SGRPID) for legacy grants schemes has not been received on time and there are issues in relation to its completeness/ accuracy. There is a risk that expenditure will be understated at the year end.</p> <p>The Forestry Grant Scheme (FGS) is a discrete scheme under the Scottish Rural Development Programme. FCS is the Scheme Manager and is now liable for any EU penalties that may arise. There is a risk that FCS does not properly provide for potential disallowances.</p>	<ul style="list-style-type: none"> • Minute review of SGRPID/ FCS joint meetings. • Review and reliance on the grant work undertaken by Internal Audit. • Review of year end accrual for legacy grant payments. • Monitor any potential disallowance for the FGS and ensure accounting treatment is appropriate. 	<p>We reviewed SGRPID/ FCS joint meeting minutes and the work of internal audit. In addition, we undertook year end testing of the legacy grant payment accrual. No issues were identified.</p> <p>We have been advised of a potential disallowance for FCS schemes. This amount is not material.</p>

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





















<p>4 Financial management and financial sustainability</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"> • FCS does not have medium or long term financial plans in place. • FCS may be impacted by the outcome of Scottish Government spending reviews. • The outcome of the EU referendum led to uncertainty over future European funding, which is a significant source of income for Forestry Commission Scotland. 	<ul style="list-style-type: none"> • Monitor progress on medium to long-term financial planning. • Monitoring of quarterly finance reports. • Ledger interrogation through the use of IDEA. • Place reliance on Internal Audit's review of EU grant schemes and payments. • Review action taken in respect of NFI matches. • Undertake performance audit work on European funding. 	<p>See parts 2 & 3 of this report.</p>
<p>5 Governance and Transparency</p> <p>There are a number of significant ongoing organisational change programmes:</p> <ul style="list-style-type: none"> • Forestry Governance Programme: this project 	<ul style="list-style-type: none"> • Follow up on any outstanding matters raised in relation to recording related party disclosures in the register of interests. • Follow up to our 2010 Role of Boards Report. • Monitor the Scottish Government's Review of 	<p>Refer to part 4 of this report.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>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"> 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. 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. 	<p>the future of Forestry in Scotland and consider the impact on the organisation.</p> <ul style="list-style-type: none"> Early review of Internal Audit work and early discussion on any material issues arising. Review progress on workforce planning. Monitor progress on testing plans for business continuity. 	
<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>		

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

[Supporting Scotland's economic growth](#) – July 2016

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

[Managing new financial powers: an update](#) – March 2017

Forestry Commission Scotland

2016/17 Annual Audit Report

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