

Forest Enterprise Scotland

2017/18 Annual Audit Report



 AUDIT SCOTLAND

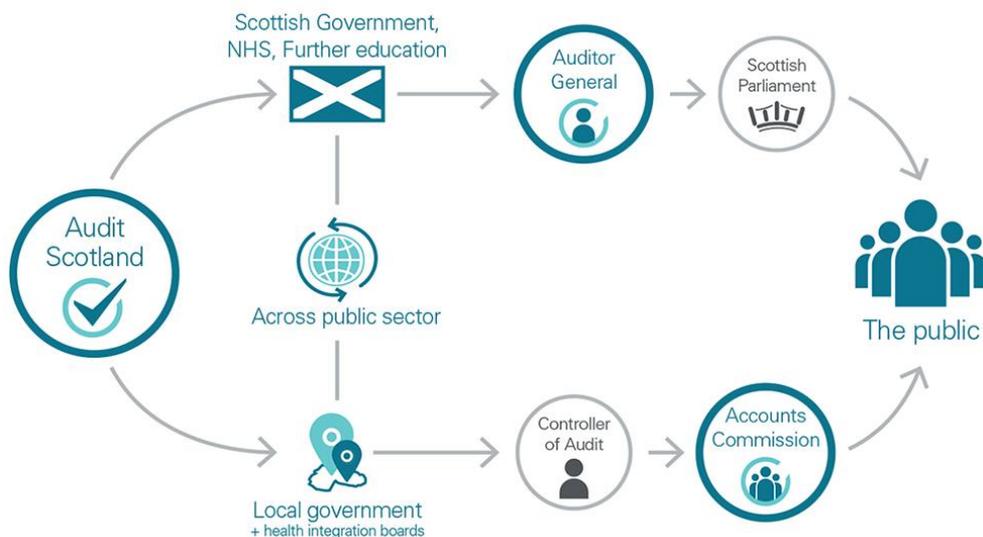
Prepared for Forest Enterprise Scotland and the Auditor General for Scotland

9 August 2018

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

2017/18 annual report and accounts

- 1 The financial statements of Forest Enterprise Scotland give a true and fair view of the financial position and its net income for the year.
- 2 The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.
- 3 The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

Financial management

- 4 Additional finance staff have been employed during the year. Until these staff become suitably knowledgeable and experienced, there is a risk that financial management may not be fully effective.
- 5 Systems of internal control operated effectively in 2017/18. Internal Audit identified a number of areas for improvement and management are addressing these going forward.

Financial sustainability

- 6 Forest Enterprise Scotland continues to develop and refine its medium to long term financial planning arrangements. This work continues to progress alongside development of the new Forest and Land Scotland corporate plan.

Governance and transparency

- 7 Forest Enterprise Scotland has appropriate governance arrangements in place that support scrutiny of decisions.
- 8 Forest Enterprise Scotland continues to improve the disclosures in its annual report. Openness and transparency could also be improved by extending the availability of papers and minutes.
- 9 Forest Enterprise Scotland has made good initial progress towards transitioning into the Forestry and Land Scotland Executive Agency. Significant continuing work is required for the new Agency to be fit for purpose from 1 April 2019.

Value for money

- 10 Forest Enterprise Scotland has overall arrangements in place which support performance management.
- 11 Forest Enterprise Scotland met four of their seven targets in 2017/18.
- 12 There is scope to build on existing approaches to managing and publicly reporting organisational performance and demonstrating the contribution this makes to the Scottish Government's outcomes.

Introduction

1. This report summarises the findings from our 2017/18 audit of Forest Enterprise Scotland.

2. The scope of our audit was set out in our Annual Audit Plan presented to the February 2018 meeting of the Audit and Risk Committee. This report comprises the findings from:

- an audit of Forest Enterprise Scotland's annual report and accounts
- consideration of the four audit dimensions that frame the wider scope of public audit 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 2017/18 have been:

- a review of the main financial systems
- an audit of Forest Enterprise Scotland's 2017/18 annual report and accounts including the issue of an independent auditor's report setting out our opinions
- consideration of the four audit dimensions.

4. Forest Enterprise Scotland has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual report and

accounts that are in accordance with the accounts direction from the Scottish Ministers. Forest Enterprise Scotland's annual report and accounts includes the following:

- Performance Report
- Accountability Report (which includes the Corporate Governance Report, Remuneration and Staff Report and Parliamentary Accountability Report)
- Financial statements and supporting notes.

5. Forest Enterprise Scotland is also responsible for establishing effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

6. Our responsibilities as independent auditor are outlined in the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#) and supplementary guidance, and International Standards on Auditing in the UK.

7. As public sector auditors we give independent opinions on the annual report and accounts. We also review and provide conclusions on the effectiveness of the performance management arrangements, suitability and effectiveness of corporate governance arrangements, and financial position and arrangements for securing financial sustainability. In doing this we aim to support improvement and accountability. 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. This report raises matters from the audit of the annual report and accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work, and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

9. Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and the steps being taken to implement them.

10. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services. We are not aware of any relationships that could compromise our objectivity and independence. We refer to the audit fee at paragraph 19 below.

Adding value through the audit

11. Our aim is to add value to Forest Enterprise Scotland by increasing insight into, and offering foresight on, financial sustainability, risk and performance, by identifying areas of improvement and by recommending and encouraging good practice. In so doing, we aim to help the board promote improved standards of governance, better management and decision making and more effective use of resources.

12. 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 in due course.

13. 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 2017/18 annual report and accounts



Main judgements

The financial statements of Forest Enterprise Scotland give a true and fair view of the financial position and its net income for the year.

The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

Audit opinions on the annual report and accounts

14. The annual report and accounts for the year ended 31 March 2018 were agreed to be passed to the Accountable Officer for signing by the Audit and Risk Committee on 27 July 2018, subject to minor update. We reported within our independent auditor's report that in our opinion:

- the financial statements give a true and fair view and were properly prepared
- expenditure and income were regular and in accordance with applicable enactments and guidance
- the audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the accounts direction.

15. Additionally, we have nothing to report in respect of misstatements in information other than the financial statements, the adequacy of accounting records and the information and explanations we received.

Submission of annual report and accounts for audit

16. Following the ill health and subsequent resignation of a key member of finance, management took action and employed a temporary member of staff to prepare the financial statements. As a consequence, we received incomplete draft financial statements on 7 June and a final unaudited version on 15 June. This was later than originally planned. The expected date of receipt was by 31 May 2018.

17. We request a full set of supporting working papers with the draft accounts in order to ensure a smooth audit process. Working papers were not received until 15 June when the revised draft accounts were submitted for audit. In addition, due to the unavailability of other staff and the steep learning curve being experienced by the temporary member of staff, audit queries were not answered as quickly as expected.

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.

18. A number of outstanding matters were discussed with Finance staff on 19 July 2018. At that time, we were advised of an error in the inventory values reported in the Statement of Financial Position which resulted in an increase in the reported net income figure (£1.3m). This amendment together with all other outstanding changes were received on 20 July 2018.

19. The delay has had an impact on the audit process. Additional audit input was required, alongside good support from available finance staff, to ensure the audit process could be completed in line with the pre-agreed timetable. We have advised management that we intend to seek an additional audit fee in addition to the 2017/18 agreed audit fee of £62,500 as set out in our Annual Audit Plan. This is required to cover our additional costs and will be discussed further with management.

Risk of material misstatement

20. [Appendix 2](#) provides a description of those assessed risks of material misstatement that were identified during the planning process. These risks had the greatest effect on the overall audit strategy, the allocation of staff resources to the audit and directing the efforts of the audit team. Also included within the appendix are wider audit dimension risks, how we addressed these and conclusions.

Materiality

21. Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement. It is affected by our perception of the financial information needs of users of the financial statements.

22. Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit. We assess the materiality of uncorrected misstatements, both individually and collectively.

23. On receipt of the annual report and accounts we reviewed our materiality calculations and updated these to reflect the reported outturn at 31 March 2018 as summarised in [Exhibit 2](#).

Exhibit 2

Materiality values

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 2018	£1.5 million
Performance materiality for biological assets, forest estate and land.	£1.4 million
Performance materiality for Statement of Comprehensive Net Expenditure and rest of the Statement of Financial Position items.	£0.9 million
<p>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:</p> <ul style="list-style-type: none"> for biological assets, forest estate and land, the performance materiality level is 60% of 1% of total assets less total liabilities; as this exceeds our overall materiality we have revised this level to £1.4m 	

Materiality level	Amount
<ul style="list-style-type: none"> for the Statement of Comprehensive Net Expenditure and the rest of the Statement of Financial Position items, the performance materiality level is 65% of planning materiality 	
<p>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</p>	£77,000

Source: Annual Audit Plan 2017/18

How we evaluate misstatements

24. There were a number of amendments processed in the accounts during the audit. Net operating income decreased by £1.49m and total taxpayer's equity decreased by £2.30m. 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 and no further audit testing was required.

25. In addition, a number of presentational adjustments to the accounts were identified and discussed with finance staff who agreed to amend the financial statements.

Significant findings from the audit in accordance with ISA 260

26. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance. 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](#) has been included.

27. These findings include our views about significant qualitative aspects of Forest Enterprise Scotland's accounting practices including:

- | | |
|---|---|
| <ul style="list-style-type: none"> Accounting policies | <ul style="list-style-type: none"> Accounting estimates and judgements |
| <ul style="list-style-type: none"> Significant financial statements disclosures | <ul style="list-style-type: none"> Timing of transactions and the period in which they are recorded |
| <ul style="list-style-type: none"> The impact on the financial statements of any uncertainties | <ul style="list-style-type: none"> The effect of any unusual transactions on the financial statements |
| <ul style="list-style-type: none"> Misstatements in the annual report and accounts | <ul style="list-style-type: none"> Disagreement over any accounting treatment or financial statements disclosure |

Exhibit 3

Significant findings from the audit of financial statements

Issue	Resolution
<p>1. Revaluation of forest estate, land and buildings and biological assets</p> <p>The accounts record total non-current assets of £2.272m of which £2.254m relates to assets which are subject to independent professional revaluation every five years. An independent professional revaluation was undertaken as at 31 March 2018.</p> <p>The revaluation has added over £227m to the asset value recorded in the financial statements.</p> <p>New valuers were appointed in 2017/18 and they reviewed the basis of the valuation and the assumptions applied therein.</p> <p>We discussed the reasons behind this increase particularly as the assets are subject to annual indexation in the intervening period. We discuss this further at paras 31-33 below.</p>	<p>We discussed the revaluation process with both Forest Enterprise staff and the Valuer.</p> <p>We also assessed the competency of the valuer and agreed that we were able to rely on the opinion of the expert.</p> <p>We have requested and received assurances from the Accountable Officer that the valuation assumptions have been considered appropriate.</p> <p> Recommendation 1 (refer appendix 1, action plan)</p>
<p>2. Provisions</p> <p>Included within provisions of £3.9m (note 14 of the financial statements) is:</p> <ul style="list-style-type: none"> • £0.68m in respect of 36 shared service staff. (The costs included within the provision reflect Forest Enterprise Scotland's share.) • £2.9m in respect of legal claims <p>The provisions have been assessed against the requirements of IAS 37 which requires a provision to be recognised when, three specified conditions are met:</p> <ul style="list-style-type: none"> • The body has a present obligation as a result of a past event • It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation • A reliable estimate can be made of the amount of the obligation. 	<p>We agreed that the costs recorded as provisions met the requirements of IAS37.</p>
<p>3. Exit packages</p> <p>The remuneration and staff report records exit packages paid to nine staff at a total cost of £342,000. Six Forest Enterprise Scotland staff left due to the closure of the Signs unit and other operational changes within the organisation. Three staff were employed within shared services and this cost was split across Forestry Commission Scotland, Forest Enterprise Scotland and Forestry Commission England.</p> <p>In 2016/17, we reported that Forest Enterprise Scotland did not bear any of the exit package costs. In 2017/18, the allocation of costs has been formally agreed across all three organisations.</p>	<p>We recommended in 2016/17 that funding decisions should be formally recorded as evidence of the agreement.</p> <p>Evidence was provided of agreement of the allocation of costs. A disclosure has been included in the remuneration report to this extent.</p>

Issue	Resolution
<p>4. Forest estate and biological assets</p> <p>The accounts record forest estate assets of £948m and biological assets of £945m.</p> <p>In previous years, the valuation of these assets was based on a random sample of assets (between 8-10%). At the revaluation undertaken by the new valuers at 31 March 2018, the sample percentage was reduced to 5-8%. This reduction was considered appropriate due to comments received from the previous valuer on the integrity of information held on the FES Forester database which was confirmed to be accurate and reliable for use by the valuer.</p> <p>In between these formal valuations, the valuer provides custom indices which are applied by Forest Enterprise Scotland staff to restate the asset 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 2018.</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 2018.</p>
<p>5. Contingent liabilities: open cast coal sites</p> <p>Note 20 of the financial statements refers to contingent liabilities of around £2.9m, reduced from £17.4m in 2016/17, which relate 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.</p> <p>The reduction in the contingent liability disclosure reflects the completed restoration of Dunstonhill and Netherton and the expected completion of Chalmerston in 2018/19. Management consider that all restoration work will be completed in 2018/19 and the contingent liability disclosure will no longer be required.</p> <p>Management continue to monitor progress.</p>	<p>The Accountable Officer has provided assurances, that 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 2018.</p>
<p>6. Remuneration and staff report</p> <p>The remuneration and staff report in the annual report and accounts presented for audit was incomplete and required management review and assessment against the requirements of the Financial Reporting Manual (FRoM).</p>	<p>Management assessed the disclosures required with reference to the FRoM and underlying guidance.</p> <p>We concluded that the revised disclosures meet the requirements of the FRoM.</p>
<p>7. Inventories</p> <p>During the audit, a query was raised in relation to the inventory value and the related evidence supporting this figure. On 19 July 2018, we were advised of an adjustment of £1.3m based on revised working papers. Incorrect values had been processed in the sales recording package which led to the incorrect value.</p> <p>The revised values were confirmed by the Head of Marketing and Sales.</p>	<p>Management should introduce appropriate checking processes to ensure that calculated / derived figures are correctly recorded.</p> <p> Recommendation 2 (refer appendix 1, action plan)</p>

Issue	Resolution
<p>8. Cash and cash equivalents</p> <p>The framework agreement between the Scottish Government and Forest Enterprise Scotland states that, unspent cash balances relating to trading and revenue income may be accumulated to a maximum of 15% of total managed expenditure. The cash balance held at 31 March 2018 is in excess of this limit.</p> <p>Agreement has been sought 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>Management await the agreement of the Cabinet Secretary for the Rural Economy and Connectivity to the holding of cash in excess of the amount permitted in framework agreement.</p> <p> Recommendation 3 (refer appendix 1, action plan)</p>

Source: Audit Scotland

Other findings

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

Cash and cash equivalents

29. The statement of financial position discloses a cash balance of £37.8m. The increase, from £31.5m (and from £19.7m in 2015/16), reflects an increase in income generating activities. 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 recognition of the levels of cash balances being built up, Forest Enterprise Scotland are currently reviewing whether they might be able to offset some of this carry forward against future grant funding.

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

- £2.4m is ring fenced. £1.7m is earmarked as a bond for opencast restoration and £0.5m is related to a cabin development and £0.2m relates peatland restoration work due to complete in 2018
- £5.5m from land sales has been earmarked to sustain woodland creation activity
- £3.2m has been set aside for the completion of programmes affected by weather or other short-term delays
- £27.6m accumulated trading surplus. Of this £4.0m has been allocated into the 2017/18 Business Plan for preparation for forestry devolution, deferred land management programmes and potential contingent liabilities
- The remaining £14.9m is for carry forward for mitigation against fluctuations in trading income.

Revaluation of non-current assets

31. As noted above the newly appointed valuer undertook a full professional revaluation of non-current assets (forest estate, land, dwellings and biological assets). Total revaluation of these assets totalled £227m of which 45% of the revaluation related to forest land. The valuer advised that this increase was due to a re-categorisation of the open land from a historic description of low value, poor

quality land incapable of growing crops, to land which now reflects environmental and conservational attributes, attracting a higher market value. Forest Enterprise Scotland agreed with this re-categorisation.

32. The methodology used for valuing forest estate and biological assets remained as previously applied. However, the valuer considered the previous tree age bandings too specific (5 year bandings), and applied 10 year age bandings. This change together with strong market conditions and encouraging timber price indices has led to an increase in valuation of £123.4m. The index for 2017/18 was 28.2% higher in real terms in the year to March 2018 when compared with the previous year.

33. The annual indexation exercise aims to avoid this large increase in asset value every five years. Management, together with the valuer, should review the processes and indices to assess whether they are appropriate in supporting the valuation of the asset base.



Recommendation 1

We recommend that management, together with the valuer, should review the processes and indices to assess whether they are appropriate in supporting the valuation of the asset base

(refer appendix 1, action plan).

Forest Holidays / Camping in the Forest

34. The accounts record the fair value of Forest Enterprise Scotland's investments in Forest Holidays (£2.050m) and in Camping in the Forest (£1.033m). During 2017/18, the Forest Holidays principle shareholder decided to sell their majority stake (£110m) in the business. This included the repayment of all Forestry Commission loan notes and restructuring of the Forestry Commission's equity interest in the company. The Forestry Commission interest as a minority shareholder in the sale, and the deal reached with the new owner was overseen by a Forestry Commission Great Britain group comprising representatives from Forestry Commission England, Forest Enterprise England, Forest Enterprise Scotland and Natural Resources Wales.

35. The Forestry Commissioners now have a 13.4% equity investment in Forest Holidays and a 28% equity investment in Camping in the Forest. The refinancing should provide access for capital funding of up to £60 million to develop up to six new cabin sites across England, Scotland and Wales. The Cabinet Secretary for the Rural Economy and Connectivity was kept advised on progress of the refinancing of the Forest Holidays.

36. We have relied on the auditors of Forest Enterprise England who undertake work as part of the National Audit Office framework contract. They were able to provide assurance over the balances recorded in Forest Enterprise Scotland 2017/18 accounts.

Follow up of prior year recommendations

37. We have followed up actions agreed in 2016/17 to assess progress with implementation. We have reported progress of these prior year actions in [Appendix 1](#). They are identified by the prefix b/f (brought forward).

38. Five agreed actions were raised in 2016/17. Of these:

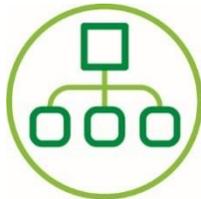
- Three have been fully implemented

- Two are continuing and will be considered following the creation of the new agency.

39. Overall Forest Enterprise Scotland has made progress in implementing these actions. For actions not yet implemented, revised responses and timescales have been agreed with management, as set out in [Appendix 1](#).

Part 2

Financial management



Main judgements

Additional finance staff have been employed during the year. Until these staff become suitably knowledgeable and experienced, there is a risk that financial management may not be fully effective.

Systems of internal control operated effectively in 2017/18. Internal Audit identified a number of areas for improvement and management are addressing these going forward.

Financial performance in 2017/18

40. The main financial objective for Forest Enterprise Scotland is to ensure that the financial outturn for the year operated within its agreed budget in 2017/18.

41. Forest Enterprise Scotland has reported net operating income of £48.8 million remaining within its overall budget for 2017/18 with an underspend of £57.6 million recorded against budget. The financial performance is shown in [Exhibit 4](#).

Exhibit 4

Financial performance

Financial Performance	2017/18 budget £m	Actual outturn £m	Overspend/ (underspend) £m
Total managed expenditure	117.0	151.5	34.5
Total managed income	(86.5)	(89.0)	(2.5)
Net operating expenditure/(income)	30.5	62.5	32.0
(Gain)on revaluation of biological assets	-	(86.7)	(86.7)
Net expenditure/(income) after gain on biological assets	30.5	(24.2)	(54.7)
(Gain)/ Loss on sale of properties	-	(3.3)	(3.3)
FCS contribution: revenue	(21.7)	(20.7)	1.0
FCS contribution: peatlands		(1.9)	(1.9)
Net expenditure/ (income)	8.8	(50.1)	(58.9)

Financial Performance	2017/18 budget £m	Actual outturn £m	Overspend/ (underspend) £m
FCS grant: capital	1.6		

Source: Forest Enterprise Scotland budget report 2017/18; 2017/18 Annual Report and Accounts

42. A number of adjustments were made to the original budget. The Scottish Government agrees the level of subsidy to be paid by Forestry Commission Scotland. In addition to the original £20.7m DEL provided, a further £1.9m was transferred to Forest Enterprise Scotland for ongoing peatland restoration projects. Forestry Commission Scotland transferred a further £0.5m for additional services provided as part of the organisational change.

Budgetary processes

43. We reviewed Forest Enterprise Scotland's budgetary processes and budget monitoring arrangements. From our review of budget monitoring reports, review of committee papers and attendance at committees we confirmed that senior management and members receive regular, timely and up to date financial information on the financial position.

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

Systems of internal control

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

46. Our findings were included in the management report presented to the Audit and Risk Committee in July 2018. We concluded that the controls tested were operating effectively. 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 to result in a material misstatement in the financial statements. Internal Audit identified a number of areas for improvement and management are addressing these going forward (refer to para 81 below).

ICT controls

47. Our ICT audit work focussed on cyber resilience (see para 97 below). We also undertook a review the Sales Recording Package (SRP) high level controls and followed up findings reported in our 2016/17 Interim Report. The findings arising from this work have been reported in our 2017/18 management report.

Financial capacity

48. We noted above the impact that a key member of the finance member leaving the organisation had on the year end preparation and audit process. The finance department increased its capacity during 2017/18 as a result of forestry devolution and the internal restructuring programme. Until these staff become suitably knowledgeable and experienced, there is a risk that effective financial management may not be fully effective.

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

Part 3

Financial sustainability



Main judgements

Forest Enterprise Scotland continues to develop and refine its medium to long term financial planning arrangements. This work continues to progress alongside development of the new Forest and Land Scotland corporate plan.

2017/18 financial position

49. 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.

50. The financial statements show that Forest Enterprise Scotland has net assets of £2,323m, an increase of £193.7m largely attributable to the quinquennial revaluation of buildings, biological assets and the forest estate.

Financial planning

51. Forest Enterprise Scotland's expenditure is met largely by income from its trading activities with the balance being funded by Forestry Commission Scotland grant (approximately 20%). Forest Enterprise Scotland also receives capital funding for forest sales funds, land acquisitions, woodland creation and provision of starter farms.

52. Forest Enterprise Scotland budgeted net expenditure for 2018/19, excluding Forestry Commission Scotland contribution, is £31.1m. This is an increase in budgeted net expenditure of £0.6m from 2017/18. Forestry Commission Scotland's contribution has reduced by £1m to £19.7m for 2018/19 resulting in overall budgeted net expenditure of £11.4m for 2018/19.

53. Fluctuations in timber income and cost pressures present continuing challenges in maintaining the financial sustainability of Forest Enterprise Scotland. As highlighted above, cash balances are being managed to offset these fluctuations.

Medium to long term financial planning

54. We reported in our 2016/17 Annual Audit Report, that Forest Enterprise Scotland was in the process of developing a Financial Strategy and Long-Term Finance Plan 2017/27. This work continues alongside the development of the new Forest and Land Scotland corporate plan.

55. Management have also advised that they are reviewing investment options as part of their longer term planning processes. This acknowledges the cash reserves currently being achieved and considers options for its utilisation across high value,

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.

one off or transformational items. The use of the cash reserves should align with the new corporate plan and the strategic objectives.

56. These investment options should be considered as part of the longer term financial strategy which should be supported by clear and detailed financial plans.



Recommendation 4

We recommend that a longer-term financial strategy (5 years +) supported by clear and detailed financial plans (3 years +) is prepared. This should include scenario planning (best, worst, most likely) with a much clearer assessment of the impact of budget assumptions on activity and any residual risks.

(refer appendix 1, action plan).

EU withdrawal

57. There remains significant uncertainty about the detailed implications of EU withdrawal (i.e. Brexit). It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- Workforce – the extent to which changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour.
- Funding – the extent to which potential changes to funding flows are likely to affect the finances of the organisation and the activity that such funding supports.
- Regulation – the extent to which potential changes to regulation across a broad range of areas overseen at an EU level are likely to affect the activities of the organisation.

58. Forest Enterprise Scotland has recognised that the principal impact of Brexit will be on exchange rates and economic growth: these are currently both favourable to domestic timber trading. Management have also advised that they are in dialogue with their contractors to ensure they recognise the impact of Brexit on their workforce. Forest Enterprise Scotland do not consider that EU withdrawal will have a significant impact elsewhere on their services.

Part 4

Governance and transparency



Main judgements

Forest Enterprise Scotland has appropriate governance arrangements in place that support scrutiny of decisions.

Forest Enterprise Scotland continues to improve the disclosures in its annual report. Openness and transparency could also be improved by extending the availability of papers and minutes.

Forest Enterprise Scotland has made good initial progress towards transitioning into the Forestry and Land Scotland Executive Agency. Significant continuing work is required for the new Agency to be fit for purpose from 1 April 2019.

Governance arrangements

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 Scottish 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.

62. 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. At 31 March 2018, the board consisted of the Chief Executive of Forest Enterprise Scotland and eight Heads of Service. In 2017/18 there were twelve board meetings.

63. The National Committee for Scotland has established an Audit and Risk Committee (ARC) to support it in its responsibilities for the effective management of risk, control and governance. The ARC works across both Forestry Commission Scotland and Forest Enterprise Scotland. During the year, the chair of the ARC stepped down due to a conflict of interests. The Chair was replaced and another non-executive member of the National Committee was appointed to the ARC.

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. We attend all ARCs. Agendas follow a standard format and papers are circulated to members in advance, allowing adequate time for members to review. From attendance at ARCs, we are satisfied that members provide appropriate scrutiny of submitted reports. In particular, we considered that the ARC demonstrated good practice in its scrutiny of management in connection with the internal audit reports on finance support visits, contract management and procurement.

65. The Chief Executive left Forest Enterprise Scotland on 18 April 2018. Trefor Owen (previously Head of Land Management) was subsequently appointed as the Interim Chief Executive / Interim Accountable Officer until a permanent appointment is made.

66. Forest Enterprise Scotland maintains its 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 governance arrangements in place support effective working relationships between senior management, chief officers, non-executives and commissioners.

Forestry and Land Management (Scotland) Act

67. The Forestry and Land Management (Scotland) Act received Royal Assent on 1 May 2018. The Act provides a modern legislative framework to develop, support and regulate forestry in Scotland, including a requirement for a Scottish forestry strategy and a duty to promote sustainable forest management. As a result of the Act, Forest Enterprise Scotland will be replaced by a new Agency, Forestry and Land Scotland. The new Agency will come into operation on 1 April 2019.

68. The Interim Chief Executive is responsible for the delivery of this project and is supported by a New Agency Project Board and the Scottish Government Forestry Devolution Programme Board. The project has been split into seven workstreams.

- Human Resources
- Digital Services
- Finance and Procurement
- Assets
- Corporate and Culture
- Office Administration
- Brand

69. Each workstream has been allocated a lead and a detailed plan is in place for each of the workstreams. Regular project highlight reports are prepared covering a range of issues including: workstream changes; project plan status; status against milestone; progress made since the previous report; project issue; key risks; action for the next period. The Guidance on Establishment of New Public Bodies (December 2017) issued by the Scottish Government has been followed where appropriate.

70. The most recent project highlight report identifies a budget of £5.3m transition costs. Actual costs to date have not been assessed. Progress on the workstreams suggest that four are improving while three are unchanged from the previous reporting period. Actions are in place to support areas that have been identified as a key risk to the success of the project.

71. This project sits alongside a number of other Forest Enterprise Scotland change management programmes including the transfer of Forestry Commission's

shared services. Forest Enterprise Scotland has taken on responsibility for credit management and tax during 2017/18, and will become responsible for other shared services during 2018/19.

72. Forest Enterprise Scotland has a significant amount of work ahead to ensure transition to the Forestry and Land Scotland Agency in April 2019 and management acknowledge the challenges involved. We shall continue to monitor progress towards transition

Transparency

73. Transparency means that the public have access to understandable, relevant and timely information about how the board is taking decisions and how it is using resources such as money, people and assets.

74. We reported in 2016/17 that minutes of meetings of the FES Management Board, National Committee for Scotland and Scottish Executive Board are publicly available on the Forest Enterprise Scotland's website. This remains the case in 2017/18. Some background papers are available for Scottish Executive Board and National Committee meetings. Audit and Risk Committee papers and minutes are not available to the public and board and committee meetings are not open to the public.

75. Forest Enterprise Scotland continues to improve transparency in its annual report and accounts. For example, further information was provided within the performance and accountability reports. We have discussed in Part 5 of this report further improvements to performance reporting although we accept that the transition to the new Agency may constrain this in the short term.

76. As part of the transition into Forestry and Land Scotland, management should review the new organisation's openness and transparency against best practice and the Scottish Government's values of Open Government which aim to foster openness, transparency and citizen participation. This could include extending the availability of formal meeting agendas and papers on its website. Where papers include confidential information, these can be withdrawn or redacted as appropriate.

Risk management

77. We reviewed Forest Enterprise Scotland's risk management arrangements as part of our planning work. Forest Enterprise Scotland has a risk management policy and has both functional and corporate risk registers. Risk registers are reviewed on a regular basis and subject to discussion by the management board. Regular updates on the key and emerging risks are provided to the Audit and Risk Committee. There is a separate risk register for the new Agency project.

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

Internal audit

79. Internal audit provides the Accountable Officer and ARC with independent assurance on risk management, internal control and corporate governance processes. The internal audit function is carried out by the Scottish Government Internal Audit Division (SGIAD).

80. Public Sector Internal Audit Standards (PSIAS) are mandatory for all central government departments, agencies and executive NDPBs. The standards require the "chief audit executive" to provide an annual internal audit opinion and report that can be used to inform the annual governance statement.

81. The opinion provided by internal audit in 2017/18 is that of 'limited assurance' which is defined as controls are developing but weak. There are weaknesses in the current risk, governance and/or control procedures that either do, or could, affect

the delivery of any related objectives. Their opinion was based on their continuous cumulative knowledge of the control environment.

82. As noted in our Annual Audit Plan, Audit Scotland's Scottish Government audit team undertook a review of the effectiveness of the internal audit function to ensure it operates in accordance with the PSIAS. Their report, which was issued in July 2018, noted that the SGIAD meets some of the Public Sector Internal Audit Standards, but also does not comply with significant aspects of the standards. Their review of a sample of internal audit reports and supporting documentation found that significant improvements are required to comply with PSIAS and the Internal Audit Manual in audit planning, audit documentation, audit reporting and management review. No internal audit reports were identified where the underlying evidence would suggest an incorrect audit opinion or conclusion. Agreed actions have been put in place to address the issues raised.

83. We intended to place formal reliance on internal audit's work on the review, and follow up, of procurement; contract management; and finance support visit audits, all of which were given an insufficient assurance opinion. Our review of internal audit's work established that we were unable to place formal reliance on their work on contract management as supporting evidence and documentation relating to our areas of interest had not been retained. We did however use their findings to inform our audit approach. As a consequence we undertook additional testing of contracts and visited two area offices as part of our detailed audit work.

Governance Statement

84. HM Treasury's Financial Reporting Manual (the FReM) states that 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 governance statement and provides assurances around the achievement of the organisation's strategic objectives.

85. The SPFM does not prescribe a format for the annual governance statement but sets out minimum requirements for central government bodies. In 2016/17 we recommended that to assist the Accountable Officer fulfil his responsibilities, specific assurances should be sought from senior staff in the organisation. We are pleased to note that assurances were sought from FCS Heads of Service and cost centre managers. Checklists were completed and annual assurance certificates summarising the checklists were provided to the Accountable Officer covering 2017/18.

86. We noted that a number of the assurance certificates included references to issues arising. Management advised that these matters were reviewed and discussed by the management team for inclusion in the governance statement. Management have recognised that the process will need to bed down and be further refined going forward. The framework now better complies with the SPFM; process and procedures will continue to be developed and improved in 2018/19.

87. We discussed a number of amendments to the draft governance statement to better reflect the position throughout the year which management agreed to implement. We concluded that the 2017/18 governance statement complies with the guidance issued by the Scottish Ministers and, based on our knowledge and work performed, presents an appropriate picture of the governance arrangements in place.

National Fraud Initiative

88. 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 irregularity.

89. NFI activity for both Forest Enterprise Scotland and Forestry Commission Scotland is summarised in [Exhibit 5](#).

Exhibit 5

NFI activity



1,282

Matches



237

Recommended
for investigation



366

Completed/closed
investigations

Source: NFI secure website: www.nfi.gov.uk

90. Although 237 were identified as recommended matches, 366 matches were in fact investigated. The additional testing was undertaken where it proved time effective to follow up. No instances of fraud were identified from this exercise. Two errors were discovered resulting in overpayments of £16,000 which have subsequently been recovered. As a result of these errors, invoice & eFinancials authorisation procedures have been reviewed and updated. Findings from the NFI exercise were reported to the Audit and Risk Committee in November 2017.

91. Forest Enterprise Scotland has been pro-active in investigating matches and reporting the outcomes of NFI activity to the Audit and Risk Committee.

92. The 2018/19 NFI exercise is due to start in autumn 2018.

93. Audit Scotland published a national report, The National Fraud Initiative in Scotland, in July 2018. The report noted that since the last report on the NFI in Scotland in June 2016, outcomes valued at £18.6 million have been recorded. The cumulative outcomes from the NFI in Scotland since 2006/07 are now £129.2 million. These outcomes represent a significant return to the public sector at a time when Scotland's public finances continue to be under pressure.

94. The report recommended that audit committees and officers leading the NFI should review the National Fraud Initiative: self-appraisal checklist. This will ensure they are fully informed of their organisation's planning and progress in the 2018/19 NFI exercise. We would agree with this recommendation.



Recommendation 5

We recommend that the ARC review the NFI self-appraisal checklist as completed by management to ensure they are fully informed of progress on the 2018/19 NFI exercise.

(refer appendix 1, action plan).

Standards of conduct for prevention and detection of fraud and error

95. We have reviewed the arrangements in place to maintain standards of conduct including the Staff Handbook and Civil Service and Members' Codes of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

96. 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 and corruption. As noted in our management report, Forest Enterprise Scotland has established procedures for recording, monitoring, and disclosing staff and board member interests. We identified several examples of good practice. We did however recommend that guidance should be prepared to formalise procedures should a conflict of interest arise.

Cyber security

97. The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017. This requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate.

98. As information services continues to be largely provided through the Forestry Commission as a non-ministerial UK government department, limited progress has been made by Forest Enterprise Scotland. Systems are in the process of being established. Management have advised that they used the pre-assessment questionnaire as a gap analysis/scoping tool. Management have given assurances that once the new Agency is established together with the implementation of its own systems, Cyber Essentials Plus accreditation will be sought.

General Data Protection Regulation (GDPR)

99. The new GDPR came into force on 25 May 2018. This replaced the UK Data Protection Act 1998. As a Regulation, all EU member states must implement it in the same way. GDPR sets out more requirements than the DPA and has introduced new and significantly changed data protection concepts.

100. GDPR introduces a wide range of new rights for individuals in respect of their personal data. These include the right to be forgotten, the right to object to certain processing activities and to decisions taken by automated processes. Failure to comply with new GDPR data handling arrangements could result in Forest Enterprise Scotland incurring significant fines.

101. Forest Enterprise Scotland has undertaken a range of actions in preparation for the introduction of GDPR. Key actions included: development of an action plan; communications to all employees and staff training on information handling; engagement with a legal firm to identify changes in the law; and an inventory of personal data held.

102. Management have put in place arrangements to make themselves compliant with the requirements of the new regulations. However, further work is being undertaken to ensure that all processes and procedures across the business are as efficient and transparent as possible.

Part 5

Value for money



Main judgements

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

Forest Enterprise Scotland met four of their seven targets in 2017/18.

There is scope to build on existing approaches to managing and publicly reporting organisational performance and demonstrating the contribution this makes to the Scottish Government's outcomes.

Performance management

103. Value for money is a key element of our audit approach. In 2017/18, 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.

104. 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.

105. Forest Enterprise Scotland's key targets are set by the National Committee for Scotland on an annual basis. Corporate commitments are split into six themes with the key priority 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.

106. Performance against each of these targets is reported in Forest Enterprise Scotland's 2017/18 Annual Report and Accounts. Forest Enterprise Scotland met 4 of their 7 targets in 2017/18; management continue to review possible corrective action.

107. We concluded that Forest Enterprise Scotland has overall arrangements in place which support performance management.

108. Outcomes based scrutiny was one of the main recommendations arising from the Budget Process Review Group. This group was established by the Finance and Constitution Committee and the Scottish Government to carry out a fundamental review of the Scottish Parliament's budget process. It noted that an outcomes-based scrutiny approach provides a means for evaluating the economic and social outcomes being achieved by public spending and recommended that public bodies strengthen their performance planning and reporting to provide a greater focus on the delivery of outcomes.

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

109. Public bodies are required to identify and report performance measures to demonstrate their effectiveness and efficiency in service delivery and the benefits they provide to the public.

110. The performance report included within the annual report and accounts provides a range of information covering the activities of Forest Enterprise Scotland. The information includes a narrative about the organisation's priorities and objectives. As an Executive Agency of the Scottish Government, Forest and Land Scotland will be expected to take an 'Outcomes based approach' to corporate and business planning, and effectively demonstrate their contribution to the delivery of the government's Purpose and National Outcomes, as set out in the National Performance Framework. Management are fully aware of this approach and have agreed to review the performance targets and measures in place to ensure they are realistic and achievable.

111. The information provided in the annual report could be enhanced through clearer assessment of whether the priorities are being delivered and whether the aims are being achieved. A key component of this approach requires the production of a corporate and business plan together with an effective performance management reporting system. We have therefore recommended that Forest Enterprise Scotland build on its existing approaches to managing and publicly reporting organisational performance, demonstrating the contribution this makes to the Scottish Government's outcomes.



Recommendation 6

Forest Enterprise Scotland should build on its existing approaches to managing and publicly reporting organisational performance. The contribution this makes to the Scottish Government's outcomes should be demonstrated. Reporting systems may need to be developed to provide this information.

(refer appendix 1, action plan).

National performance audit reports

112. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2017/18 several reports were published which are of direct interest to Forest Enterprise Scotland. These are outlined in [Appendix 3](#).

113. We provide regular updates to the Audit and Risk Committee in which we refer to Performance Audit reports which may be of interest to members.

Appendix 1

Action plan 2017/18

2017/18 recommendations for improvement

No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p>Revaluation of forest estate, land and buildings and biological assets</p> <p>An independent revaluation of forest estate, land and buildings and biological assets was undertaken as at 31 March 2018.</p> <p>The revaluation has added over £227m to the asset value recorded in the financial statements. This is a significant increase particularly as the assets are subject to annual indexation in the intervening period.</p> <p>Risk</p> <p>There is a risk that non current assets are not valued appropriately.</p>	<p>Management, together with the valuer, should review the process and indices to assess whether they are appropriate in supporting the valuation of the asset base.</p> <p>Management should also ensure they are satisfied with the basis of the valuation and the assumptions applied.</p> <p>Exhibit 3, issue 1 Paragraph 33</p>	<p>A review will be undertaken.</p> <p>Responsible officer: Mary Lindsay Estates Strategy, Policy & Development Manager</p> <p>Agreed date: December 2018</p>
2	<p>Inventories</p> <p>Incorrect figures relating to the inventory values were input to the sales recording package resulting in a late correction.</p> <p>Risk</p> <p>There is a risk that without suitable management oversight and review, the inventory values are misstated.</p>	<p>Appropriate checking processes should be introduced to ensure that calculated / derived figures are correctly recorded.</p> <p>Exhibit 3, issue 7</p>	<p>A review will be undertaken</p> <p>Responsible officer: Mick Bottomley, Head of Marketing & Sales</p> <p>Agreed date: December 2018</p>
3	<p>Cash and cash equivalents</p> <p>The framework agreement states that, unspent cash balances relating to trading and revenue income may be accumulated to a maximum of 15% of managed expenditure. Cash balances held at 31</p>	<p>Any cash balances in excess of those agreed in the framework document should be agreed with the Cabinet Secretary</p> <p>Exhibit 3, issue 8</p>	<p>We will make every endeavour to achieve this. A fundamental review of the Framework document will be in progress for FLS and this should resolve future issues of cash reserves.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>March are in excess of this limit.</p> <p>Agreement from the Cabinet Secretary for the Rural Economy and Connectivity has been sought but not yet received.</p> <p>Risk</p> <p>Agreement to the carry forward of additional cash reserves may not be given resulting in future return of funds.</p>		<p>Responsible officer: Donna Mortimer, Head of Finance and Procurement</p> <p>Agreed date: Ongoing</p>
4	<p>Medium to long term financial planning</p> <p>Longer term financial planning should continue to be developed along with the development of the new forestry strategy and the Forest and Land Scotland corporate plan.</p> <p>Risk</p> <p>There is a risk that the impact of budget assumptions on agreed or projected outputs is not effectively recognised.</p>	<p>We recommend that once devolution of central services is complete and arrangements for the new Agency are more settled that, a long term financial strategy (5 years +) supported by clear and detailed financial plans (3 years +) is prepared.</p> <p>Plans should set out scenario plans (best, worst, most likely); with a much clearer assessment of the impact of budget assumptions on activity and any residual risks.</p> <p>Paragraph 56</p>	<p>This is in line with management plans and will be progressed in 2018/19,</p> <p>Responsible officer: Donna Mortimer, Head of Finance & Procurement.</p> <p>Agreed date: ongoing</p>
5	<p>NFI</p> <p>The NFI self-appraisal checklist was not provided to the ARC.</p> <p>Risk</p> <p>There is a risk that the ARC is not kept apprised of progress on the NFI exercise.</p>	<p>The ARC should review the NFI self-appraisal checklist as completed by management to ensure they are fully informed of progress on the 2018/19 NFI exercise</p> <p>Paragraph 94</p>	<p>This will be addressed as part of the new ARC arrangements for FLS.</p> <p>Responsible officer: Donna Mortimer, Head of Finance & Procurement.</p> <p>Agreed date: July 2019</p>
6	<p>Performance management</p> <p>Information provided in the annual report could be enhanced through the assessment of whether the priorities are being delivered and whether the aims are being achieved.</p> <p>Risk</p>	<p>Forest Enterprise Scotland should build on its existing approaches to managing and publicly reporting organisational performance. The contribution this makes to the Scottish Government's outcomes should be demonstrated.</p>	<p>This is in line with management plans and will be progressed in 2018/19.</p> <p>Responsible officer: Michael Hymers, Head of Corporate Support.</p> <p>Agreed date: April 2019</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	There is a risk that the new Agency cannot demonstrate its progress in achieving Scottish government performance targets.	Reporting systems may need to be developed to provide this information. Paragraph 111	

Follow up of prior year recommendations

b/f 1	<p>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>	The accountable officer should request specific written assurances on the range of internal control systems directly managed by senior officers.	<p>Measures have been put in place to comply with the recommended assurance framework. Our 2017/18 audit of the Governance Statement confirmed that the Statement complies with the SPFM. Further improvements will be made in 2018/19.</p> <p>Conclusion: Actioned</p>
b/f 2	<p>Material errors</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>	Management should review the underlying causes of these errors to ensure no recurrence going forwards.	<p>A review was undertaken for both occurrences. As part of this, improvements were made to the templates FES use to generate the correct accounting, staff were reminded of SRP input and checking requirements and FESHO implemented procedures to reviewing year end accruals, Thorough review of EOY accruals including investigation of variances.</p> <p>Conclusion: Actioned</p>
b/f 3	<p>Bad debt provision</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>	Management should review procedures for providing for potential bad debts.	<p>Agreed action date was December 2018. 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>Conclusion: Ongoing</p>
b/f 4	<p>Exit packages</p> <p>Forestry Commission Scotland funded the full cost of exit</p>	Funding decisions should be formally recorded as evidence	The Scottish element of early exit costs for three former shared service employees has been allocated to both Forestry



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>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>of the discussions and subsequent agreement.</p>	<p>Commission Scotland and Forest Enterprise Scotland for the 2017/18. Evidence of management agreeing to split the costs has been provided for our financial statements audit.</p> <p>Conclusion: Actioned</p>
b/f 5	<p>Financial planning</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>We note that, due to competing work demands, the long term financial planning development will be delayed until after the creation of the new Agency</p> <p>Conclusion: Ongoing</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
Risks of material misstatement in the financial statements		
<p>1 Risk of management override of controls</p> <p>ISA 240 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>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of year-end payables and receivables.</p> <p>Substantive cut-off testing of income and expenditure to ensure that these have been recognised in the correct financial year.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p> <p>Review of internal audit's work on, and subsequent follow up of, procurement, contract management and finance support visits audits. We shall also consider progress against management's action plan.</p>	<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 management report relating to instances where some journals had been input and authorised by the same person. Journals should be subject to independent review and authorisation. Management agreed to review controls and policy on journal input and authorisation.</p>
<p>2 Risk of fraud over income</p> <p>FES receives a significant amount of income in addition to Scottish Government funding.</p> <p>In 2016/17, FES received income in excess of £87.8m from other sources, including £65m from timber sales. The nature, extent and complexity of income sources mean that, in accordance with ISA 240, there is an inherent risk of fraud.</p>	<p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p> <p>Substantive cut-off testing of income to ensure it has been recognised in the correct financial year.</p> <p>Controls testing during the forest district visit, including timber income controls and timber security arrangements.</p> <p>Review of the Sales Recording Package (SRP) system and key controls.</p>	<p>Analytical procedures did not identify any unexpected variances.</p> <p>Our controls procedures 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> <p>Our review of SRP identified only minor issues.</p> <p>We were unable to rely on the Internal Audit review of contract management due to the absence of relevant evidence. Additional</p>

Audit Risk	Assurance procedure	Results and conclusions
	<p>Review of FES's anti-fraud arrangements.</p> <p>Review of internal audit's work on, and subsequent follow up of, Contract Management. We shall also consider progress against management's action plan.</p>	<p>testing was undertaken with no issues identified.</p>
<p>3 Accounting estimation and judgements</p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of non current assets and contingent liabilities.</p> <p>Forest estate/ biological asset values are based on a random sample of assets, with results extrapolated across the whole forest estate. Respective valuations of £914M and £910M in 2016/17. A quinquennial valuation of forest estate/ biological assets, land and buildings will take place in 2017/18. Land and buildings were valued at £220M and £34M respectively in 2016/17.</p> <p>A contingent liability of £17.4m was disclosed in the 2016/17 accounts in relation to the restoration of opencast coal sites.</p> <p>The 2016/17 accounts also disclosed a contingent liability for the HMRC audit, which is ongoing in 2017/18. There is a possibility of future non-compliance liabilities arising from the audit.</p> <p>This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Review the work of an expert for the professional valuer (wind farms/ hydro, and forest estate/ biological assets).</p> <p>Review of quinquennial valuation exercise and subsequent accounting adjustments.</p> <p>Review of accounting policies to ensure they are reasonable.</p> <p>Regular discussions with management on the opencast coal sites potential liability. We will also examine the accuracy and valuation of the disclosure in the financial statements.</p> <p>Regular discussions with management on the FES HMRC inspection. Examine the accuracy, completeness and disclosures in the financial statements.</p> <p>Focused substantive testing of year end balances</p>	<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 quinquennial revaluation and subsequent accounting adjustments.</p> <p>Updates on the opencast coal sites and HMRC potential liabilities took place during 2017/18 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>4 Financial sustainability</p> <p>Eighty per cent of FES' expenditure is funded by income generating activities (£88M in 2016/17). The remainder is met by a Forestry Commission Scotland (FCS) grant (£22M in 2016/17).</p> <p>Timber income in 2016/17 was £65M. Fluctuations in timber</p>	<p>Monitoring of monthly finance reports.</p> <p>Monitor impact of economic conditions on timber income in the UK.</p> <p>Review progress of long-term financial strategy and plan.</p>	<p>See parts 2 and 3 of this report.</p>
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Audit Risk	Assurance procedure	Results and conclusions
<p>income and cost pressures continue to have an impact on the financial sustainability of Forest Enterprise Scotland. Although exchange rates have been favourable for domestic timber trading, the impact of Brexit on the UK's timber industry is still largely unknown.</p> <p>There is a risk to the financial sustainability of FES, should prevailing economic conditions have an adverse effect on UK timber prices.</p>		
<p>5 Governance and transparency</p> <p>FES is currently in the process of significant organisational change following the review of Forestry Commission services. Major programmes include:</p> <p><u>Establishing Corporate Services Scotland:</u></p> <p>This programme is reviewing the transition of shared services from Forestry Commission Central Services into FCS/FES. The remaining shared services should be transferred to England and Wales by the end of March 2018 although delays have been identified.</p> <p>There is a risk that any prolonged slippage in the programme could impact on service delivery, knowledge transfer and transition to agency status (Forestry and Land Scotland). There is a further risk that internal controls may not be as effective in a period of change.</p> <p><u>Forestry and Land Management (Scotland) Bill:</u></p> <p>Forest Enterprise Scotland will become a separate, larger Agency. The following risks are associated with this period of organisational change:</p> <ul style="list-style-type: none"> • loss of key staff and knowledge due to the uncertainty • detrimental impact on the effectiveness of internal controls during a period of change, including 	<p>High level review of organisational change programmes.</p> <p>Review procedures for maintaining the register of interests including application of Your Reputation @ Risk survey (to be discussed with management).</p> <p>Monitor progress on testing plans for business continuity and review progress on implementing General Data Protection Regulation.</p> <p>Monitor progress of transition of Finance and Digital services.</p> <p>Review cyber security arrangements.</p>	<p>Refer to part 4 of this report.</p>

Audit Risk	Assurance procedure	Results and conclusions
maintenance of the register of interests <ul style="list-style-type: none">unable to provide key services alongside managing the change programme.		

Appendix 3

Summary of national performance reports 2017/18

		 2017/18 Reports	
		Apr	
		May	
Common Agricultural Policy Futures programme: further update		Jun	 Scotland's colleges 2017
		Jul	 NHS workforce planning
Self-directed support: 2017 progress report		Aug	
Equal pay in Scottish councils		Sept	
Transport Scotland's ferry services		Oct	 NHS in Scotland 2017
Local government in Scotland: Financial overview 2016/17		Nov	
		Dec	
		Jan	
Early learning and childcare		Feb	
Managing the implementation of the Scotland Acts		Mar	

Central Government relevant reports

[Common Agricultural Policy Futures programme: further update](#) – June 2017

[Transport Scotland's ferry services](#) – October 2017

[Early learning and childcare](#) – February 2018

[Managing the implementation of the Scotland Acts](#) – March 2018

Forest Enterprise Scotland

2017/18 Annual Audit Report

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