

Forest Enterprise Scotland

Report on the 2006/07 Audit



October 2007



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Executive Summary

Introduction

In 2006/07 we audited the financial statements of the Forest Enterprise Scotland (FES) and we looked at aspects of performance management and governance. This report sets out our key findings.

Financial Position

We have given an unqualified opinion on the financial statements of FES for 2006/07.

FES's Income and Expenditure Statement shows a net deficit, after cost of capital, of £29.3 million. After adjusting the total deficit for items not involving the movement in cash and for capital expenditure and receipts, the net cash funding received from the Forestry Commission Scotland (FCS) was £32.3 million. This is out with the target set by the Forestry Commission National Committee for Scotland of £31.8 million (+/- 1%).

Performance

The Scottish Government's Forestry Strategy makes a commitment to the publication of implementation plans which will help deliver the strategy during the period of the plan. Ministers have asked FCS to 'champion' the implementation of this strategy. The Scottish Forestry Strategy Implementation Plan 2007-08 contains over 120 specific action points, and the opportunity has been taken in the Implementation Plan to provide a baseline for the Scottish Forest Strategy Indicators (where this data is available) and to identify where further work is required to establish the baseline. An annual progress report is to be prepared for presentation to the Scottish Forestry Forum. FES will play a key role in delivering the strategy.

Governance

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. Overall the corporate governance and control arrangements for FES operated satisfactorily during the year, as reflected in the Statement on Internal Control and the level of assurances provided by Internal Audit.



Looking forward

As part of the 2007/08 audit we will be reviewing the progress that FES has made in strengthening their arrangements for securing Best Value since our baseline review work in 2005/06. Over the next year we will also be developing and refining our approach to the audit of public bodies' arrangements to secure economy, efficiency and effectiveness in the use of resources, as this is one of our key objectives as auditors, set out within the new Code of Audit Practice approved by the Auditor General. This will inform our ongoing work to develop an approach to the audit of Best Value across the Scottish public sector. We intend to consult with both clients and stakeholders at key stages of these initiatives.

Audit Scotland
October 2007

Introduction

1. This report summarises the findings from our 2006/07 audit of FES. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 5 March 2007. This plan described the work we planned to carry out on financial statements, performance and governance.
2. Appendix A of this report sets out the key risks highlighted in this report and the action planned by management to address them.
3. This is the first year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of FES during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk.

Financial Statements

4. In this section we summarise key outcomes from our audit of FES financial statements for 2006/07, and comment on the key financial management and accounting issues faced.

Our Responsibilities

5. We audit the financial statements and give an opinion on whether:
 - they give a true and fair view of the financial position of FES and its expenditure and income for the period in question;
 - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements; and
 - the regularity of the expenditure and receipts.
6. We also review the statement on internal control by:
 - considering the adequacy of the process put in place by the chief executive as accountable officer to obtain assurances on systems of internal control; and
 - assessing whether disclosures in the statement are consistent with our knowledge of FES.

Overall Conclusion

7. We have given an unqualified opinion on the financial statements of FES for 2006/07.

Financial Position

2006/07 outturn

8. FES is an executive agency of the Forest Commission Scotland, and manages the forest estate on behalf of Scottish Ministers. The Income and Expenditure Statement shows a net deficit, after cost of capital, of £29.3 million. After adjusting the total deficit for items not involving the movement in cash and for capital expenditure and receipts, the net cash funding received from FCS was £32.3 million in 2006-07, an increase of £4.8 million compared to the previous year.

9. The most significant costs for the year were harvesting and marketing; forest protection and maintenance; and expenditure on forest roads. Overall, these were in line with the previous year with the exception of the latter which showed a £0.9 million increase over 2005-06 and was mainly attributable to an increase in road network maintenance.
10. Income from sales of timber was £36.7 million, an increase of £1.7 million on 2005/06, reflecting an improvement in prices in the timber market in the latter part of the year and a 3% increase in despatched volume.

2007/08 budget

11. Scottish Ministers have set an initial resource budget for FCS of £84.4m for 2007/08 which includes Forest Enterprise Scotland deficit funding of £27.7million.

Issues Arising from the Audit

12. We reported the following issues to the Audit Committee on 5 July 2007:
13. **Forest Holidays** - In May 2006, the Forestry Commission entered into a joint venture with the Camping and Caravanning Club to take over management of its Forest Holidays business. The National Audit Office reviewed the accounting treatment of Forest Holidays Land and Buildings as part of our group audit arrangements. NAO concluded and officers agreed that the partnership is one of an associate company for Forestry Commission rather than a joint venture. The draft accounts presented for audit included the investment as a joint venture in FES.
14. **Audit adjustments** - A number of adjustments were required to the first draft account as a result of the audit. These were brought to the attention of FES in accordance with the agreed audit timetable and changes were made to the final version of the accounts to reflect audit adjustments. There were therefore no material unadjusted misstatements or errors identified in the final accounts.
15. **Bank reconciliations** – For 2004/05, there were difficulties arising from delays in completion of the monthly bank reconciliations. The reconciliations were brought up to date during 2005/06 and Internal Audit undertook a verification check in February 2006 to confirm that the reconciliations were continuing to be performed on time and that any outstanding adjustments had been actioned. However officers failed to obtain a “transactions and balances” download from the organisation’s bankers at 31 March 2007 in order to perform a year-end bank reconciliation in support of the financial statements. Whilst we were able to confirm the bank balance recorded in the accounts through alternative means, we have highlighted the need for proper year-end bank reconciliations to be undertaken. Officers have agreed to revise procedures in relation to year-end bank reconciliations for future years.

Refer Action Plan No. 1

Statement on Internal Control

16. The Statement on Internal Control provided by FES's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out FES's approach to this. The arrangements for Audit and Risk Committees across Forestry Commission were revised in 2006/07 with the setting up of separate Audit and Risk Committees for each country. The Scottish ARC was established in October 2006 and first met in March 2007. The strengthening of scrutiny and audit arrangements across the Forestry Commission was an important improvement in internal control.
17. The statement on Internal Control recognised that work is required in 2007-08 to develop Business Continuity Plans for business critical systems. However, the Accountable Officer has stated that he is satisfied that internal control within FES continues to provide substantial assurance that material risks to the achievement of objectives are adequately managed.

Regularity Assertion

18. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts was incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.

Performance

19. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
20. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

Scottish forestry strategy

21. The Scottish Government's Forestry Strategy makes a commitment to the publication of implementation plans containing delivery milestones aligned to available resources. Ministers have asked FCS to 'champion' strategy implementation. The Strategy is based on four key principles:
 - Sustainable development – underpinned by sustainable forest management;
 - Social inclusion - through helping to provide opportunities for all, and helping to build stronger communities;
 - Forestry for and with people; and
 - Integration with other land uses and businesses.
22. The Scottish Forestry Strategy Implementation Plan 2007/08 contains over 120 specific action points for 2007-08. Key issues for action include:
 - tackling climate change;
 - promotion of timber;
 - business development;
 - boosting community involvement;
 - improving access and health; and
 - enhancing biodiversity.

23. The opportunity has been taken in the Implementation Plan to provide a baseline for the Scottish Forest Strategy Indicators (where this data is available) and to identify where further work is required to establish the baseline. An annual progress report is to be prepared for presentation to the Scottish Forestry Forum which will feed through to subsequent plans.
24. FES will play a key role in implementing the action points.

Key performance indicators

25. Nine key agency targets were set by the National Committee for Scotland for 2006/07 for FES. The targets were generally achieved however performance results against agreed financial targets and unit cost of selected operations were mixed. By way of example:
 - the net cash funding received from the Forestry Commission Scotland was £32.3 million. This was out with the target of £31.8 million (+/- 1%);
 - the operating deficit of £3.9 million was within the target set of £4 million; and
 - total direct production unit cost (excluding haulage) of £11.20 per m³ was out with the target of £11.10 per m³.
26. There is, however, a lack of clarity over the alignment of financial targets with longer term overall aims and objectives for FES. A number of the indicators appear to focus on activities and processes rather than a more strategic view of outcomes and impacts.

Refer Action Plan No. 2

Governance

Overview of arrangements

27. This section sets out our main findings arising from our review of FES's governance arrangements.

This year we reviewed:

- key systems of internal control;
- internal audit; and
- aspects of information and communications technology (ICT).

28. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position (see paragraphs 8-10). Our overall conclusion is that arrangements within FES are sound and have operated throughout 2006/07.

Systems of internal control

29. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In her annual report for 2006/07 the head of internal audit provided her opinion that, based on the internal audit work undertaken during the year, there was reasonable assurance on the adequacy and effectiveness on the systems of internal control.

30. As part of our audit we reviewed the high level controls in a number of FES systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively.

Shared services and common account areas

31. In the interests of an efficient audit approach, Audit Scotland is best placed to complete audit testing on common systems and accounts required at FC Headquarters in Edinburgh, for the audit of the Forestry Commission England, Wales & Great Britain financial statements. This also includes any audit coverage in the Mechanical Engineering Services, Forestry Civil Engineering and Plant and Seed Supply. This approach allows the National Audit Office and Wales Audit Office to focus their testing at Districts and Conservancies in England and Wales, together with testing the Forest Enterprise England and Forest Research accounts.

32. The arrangements are designed to:
- secure proper representation of the interests of the Comptroller and Auditor General, the Auditor General for Scotland and the Auditor General for Wales in forestry accounts laid before the respective Parliaments/Assembly;
 - observe the public interest by delivering an efficient co-ordinated audit that avoids unnecessary duplication and expense; and
 - meet the Forestry Commission's expectation to deal with a single audit team wherever possible, given its single central accounting arrangements. Irrespective of the part played by different audit bodies, the audit should be integrated, resulting in a consistent audit view on accounting matters.
33. Audit Scotland carried out audit testing and provided assurance as agreed in detailed with the other audit agencies for 2006/07 accounts allowing all of the accounts to be signed off on time (NAO continued to take the lead on Forest Holidays PPP).

Review of Internal Audit

34. FES recognises that internal audit is a key element of the internal control system set up by management. A strong internal audit function is necessary to ensure the continuing effectiveness of the internal control system established. To maximise the reliance that external audit can place on internal audit and to avoid duplication of effort, the adequacy of internal audit is assessed each year.
35. Internal audit is provided by an in-house team. From our review of internal audit arrangements we are pleased to confirm that we placed reliance on their work in a number of areas during 2006/07, as we anticipated in our audit plans.
36. We placed formal reliance on the work of internal audit, in terms of International Standard on Auditing 610 on the reviews of:
- corporate governance and risk management;
 - Purchase Order Processing (POP); and
 - travel and subsistence – Employee Expenses Model (EEM).
37. We reviewed the reports and files and are satisfied that none of the observations and related risks precluded planned assurance from being taken for our financial statements audit. We did note that Internal Audit did not complete their planned work in full as a result of staffing difficulties and this is an area we will review in 2007/08 to ensure sufficient resource is deployed to meet approved audit plans. We are satisfied that sufficient work was completed to enable the Head of Internal Audit to sign off her annual statement of assurance for the accountable officer.

Information and Communication Technology

Overview

38. As part of our agreed audit activity we have conducted a review of how FES is managing Information and Communication Technology (ICT) within the organisation. Based upon interviews with key staff, supported by the review of documents provided, we identified that FES has governance arrangements in place which are designed to ensure successful compliance with ISO 27001 during 2007.
39. We did however identify a number of areas where improvements can be incorporated in to current operational practice and will monitor progress in these areas during 2007/08. These include:
- reviewing and formally approving the updated ICT Strategy during 2007;
 - ensuring good project management is implemented in all key projects; and
 - driving Business Continuity Management throughout Forestry.

Application System Review – eFinancials

40. As part of our risk based assessment of FES, we identified the eFinancials system – the main accounting ledger system - as a priority area for review. Our overall conclusion is that the eFinancials system is operating well and provides strong assurance on the accuracy and completeness of the FES's reported financial position. In particular, we identified a number of areas of good practice, including:
- a small, dedicated finance support team responsible for the day to day support of eFinancials;
 - servers hosted in a secure computer room located in Silvan House; and
 - change control records detailing patch fixes applied to the test and live environments.
41. We did, however, note a number of areas where improvements could be incorporated into current operational practice, including:
- reinforcing key controls in the eFinancials procedural manual to staff;
 - checking accuracy of all changes to standing data;
 - authorising prompt payment of batches;
 - controlling and monitoring of user access accounts; and
 - planning and documenting data migration and user acceptance testing.

Looking Forward

42. FES faces a number of challenges in 2007/08, which include:

- **Single environment and rural service (SEARS)** – The minister has asked the ‘On the Ground’ family which comprises the Forestry Commission, SEPA, Scottish National Heritage, national Parks, Deer Commission, Crofters Commission, Scottish Government Rural Payments and Inspections Directorate and the Animal Health Agency to develop a proposal for closer, more efficient, “joined-up” working within existing legal and organisational frameworks. The proposal must be ready for implementation by June 2008. FES will play a key role in developing the service.
- **International Accounting Standards** - The application of International Financial Reporting and Accounting Standards (IFRS) to central government bodies from 1 April 2008 will lead to changes in the way the accounts are presented. In particular the way in which FES accounts for its estate and land assets will change, impacting on the financial statements and financial planning. As an example, presently, FES does not separately account for trees (biological assets). Such assets are included within Land values (Forest Estate category), which includes bare land, any trees growing on it and roads, and are valued under an existing use basis. Under IAS 41, trees will require to be measured on initial recognition and at each balance sheet date at fair value. Fair value measurement stops at harvest, from which point IAS 2 *Inventories* applies. The introduction of the accounting changes will require forward planning to anticipate restatement issues and to feed into financial plans. We will work with FES to support the introduction of IFRS.
- **Best Value** – Revised guidance on best value in the wider public sector has now been issued. FES will need to ensure that it has mechanisms in place that enable it to demonstrate continuous improvement and that the principles of best value are embedded. Audit Scotland will be developing its approach to best value in the wider public sector in due course.
- **Acquisitions and disposals** – FES anticipate acquiring more land to contribute to the Woods In and around Towns Initiative. These acquisitions will in part be funded through sales of lowest performing woodland.

Appendix A: Action Plan

Key Issues and Planned Management Action

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
1	Officers failed to obtain a “transactions and balances” download from the organisation’s bankers at 31 March 2007 in order to perform year-end bank reconciliations in support of the financial statements.	To be included in year end plan.	Ian Rae	March 2008
2	Performance results against agreed financial targets and unit cost of selected operations were mixed. There is however a lack of clarity over the alignment of financial targets with longer term overall aims and objectives for the agency. A number of the indicators appear to focus on activities and processes rather than a more strategic view of outcomes and impacts.	Some of the strategic outcomes are difficult to tie down to specific targets. However, the FES Framework Document is currently being reviewed and we are refreshing all of the indicators and targets.	Paul Snaith	March 2008