

Forest Enterprise Scotland

Report on the 2008/09 Audit

September 2009

The logo for Audit Scotland, featuring a stylized blue checkmark inside a circle.

AUDIT SCOTLAND

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Report on the 2008/09 Audit

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Key messages

In 2008/09 we looked at the key strategic and financial risks being faced by Forest Enterprise Scotland (FES). We audited the financial statements and we also reviewed the use of resources and aspects of performance management and governance. This report sets out our key findings.

Financial statements

We have given an unqualified opinion on the financial statements of FES for 2008/09. We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

Financial position and use of resources

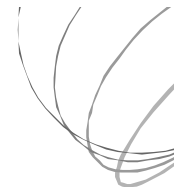
FES's Income and Expenditure Statement for 2008/09 shows a net deficit, after cost of capital of £31.5 million. After adjusting the total deficit for items not involving the movement in cash and for capital expenditure and receipts, the net cash funding received from Forestry Commission Scotland (FCS) was £26.9 million. The target set by the Forestry Commission National Committee for Scotland was £28.4 million.

FES has a 2009/10 budget of £23.6 million. Funding for FES for 2010/11 has also been set at £23.6 million. FES has highlighted a number of risks to operating within the resource budget for 2009/10 and is also required (through FCS) to make contribution to a 2% per annum cash releasing efficiency saving for the Rural Affairs and Environment portfolio in the 2009/10 and 2010/11 budget settlements. These will be challenging targets for FES to achieve and we will continue to keep developments in this area under review.

Governance and accountability

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.

We examined the key financial systems which underpin the organisation's control environment. We concluded that financial systems and procedures operated sufficiently well to enable us to place reliance on them.



Performance

The FCS corporate plan for 2008 – 2011 plan records that the Scottish Forestry Strategy is the framework for taking forestry forward through the first half of the century and beyond. The plan also uses these seven themes in the strategy to identify priorities and set out the specific actions which FCS is taking over the period 2008-2011 to help achieve its vision. FES will play a key role in delivering the Strategy.

Seven key agency targets for 2008/09 were set by the National Committee for Scotland for FES. These targets were generally achieved however performance results against agreed financial targets and unit costs were mixed.

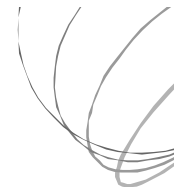
Looking forward

The final part of our report notes some key risk areas and issues for FES going forward. FES faces significant pressures to achieve financial balance in 2009/10 and the longer term. This includes no scope for application of end year flexibility for the Government with HM Treasury until next Spending Review; and the impact of the introduction of International Financial Reporting Standards (IFRS), particularly on leases and infrastructure accounting. For 2009/10 and 2010/11, FCS (including FES) are required to make contribution to a 2% per annum cash releasing efficiency saving for the Rural Affairs and Environment portfolio. We will continue to monitor plans for efficiencies and savings to achieve financial balance and FES's financial position.

We highlighted a number of national issues which affect all public sector bodies including FES, including the National Performance Framework and the impact of international financial reporting standards. We have also highlighted how the economic downturn might restrict FES's ability to generate income, notably from timber sales. We will continue to monitor how FES manages these risks.

The assistance and co-operation given to us by Board members and staff during our audit is gratefully acknowledged.

Audit Scotland
September 2009



Introduction

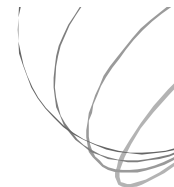
1. This report summarises the findings from our 2008/09 audit of FES. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 24 March 2009. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued a range of reports this year, and we briefly touch on the key issues we raised in this report. Each report set out our detailed findings and recommendations and the Board's agreed response. Appendix A of this report sets out the key risks highlighted in this report and the action planned by management to address them.
3. Best value duties apply across the public sector and, in central government, best value is a formal duty on all accountable officers. Audit Scotland has adopted a generic framework for the audit of best value across the public sector and throughout this report we comment on aspects of FES arrangements.

Exhibit 1: Framework for a best value audit of a public body





4. Our comments are made on the basis of information made available in the course of the annual audit. We do not make an overall best value judgement because we do not have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time. This report is the first step towards that goal.
5. Another building block for our assessment of best value is the national study programme carried out by Audit Scotland on behalf of both the Auditor General for Scotland and the Accounts Commission. We mention the key findings from all relevant reports, and the implications for FES, throughout this report. Full copies of the study reports can be obtained from Audit Scotland's website, www.audit-scotland.gov.uk.
6. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by Board members and staff during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website.



Financial Statements

7. In this section we summarise key outcomes from our audit of FES financial statements for 2008/09 and the accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

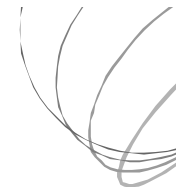
8. We audit the financial statements and give an opinion on:
- whether they give a true and fair view of the financial position of FES and its expenditure and income for the period in question
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
 - the consistency of the information which comprises FES Finances included in the Annual Report, is consistent with the financial statements
 - the regularity of the expenditure and receipts.
9. We also review the statement on internal control by:
- considering the adequacy of the process put in place by the Chief Executive as Agency Accountable Officer to obtain assurances on systems of internal control
 - assessing whether disclosures in the statement are consistent with our knowledge of FES.

Overall conclusion

10. We have given an unqualified opinion on the financial statements of FES for 2008/09.
11. As agreed the unaudited accounts were provided to us on 25 May 2009, supported by a comprehensive working paper package. We concluded our audit within the agreed timetable and provided our opinion to the Audit and Risk Committee on 1 July 2009 as timetabled.

Issues arising from the audit

12. As required by auditing standards we reported to the Audit and Risk Committee on 1 July 2009 the main issues arising from our audit of the financial statements. The main issue was as follows:



13. **Glenmore Sewage Project** – Completion of work on the Glenmore Sewage project is expected during 2009/10, at which point ownership of the scheme will pass to Scottish Water. During 2006/07 and 2007/08, project expenditure of some £202,000 by Forest Enterprise Scotland was capitalised and charged to Assets under Construction (AUC). During 2008/09, however, officers corrected their accounting treatment for the project and further expenditure of approximately £1.3 million was charged directly to the income and expenditure account. In addition the expenditure for prior years of some £202,000 was written out of AUC and also charged to the income and expenditure account. In resolution of this issue, officers have agreed to review current arrangements to ensure that expenditure is correctly classified for future years.

Regularity

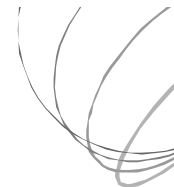
14. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the 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.

International financial reporting standards (IFRS)

15. As announced by the Chancellor in the 2008 Budget report on 12 March 2008 (Budget report paragraph C103), Government departments and other public sector bodies will report using International Financial Reporting Standards (IFRS) from 2009/10. The Scottish Government announced on 25 April 2008 that all Scottish Government Departments, Executive Agencies, Health Bodies and Non-Departmental Public Bodies would be required to produce shadow IFRS based accounts for financial year 2008/09. This was to include a restated balance sheet as at 1 April 2008.
16. In terms of the audit of the IFRS opening balance sheet at 1 April 2008, there were two key dates to achieve as outlined below:
- **28 November 2008** – opening 2008 IFRS-based balance sheet were to be presented to auditors for dry-run audit
 - **28 February 2009** – dry-run audit of opening balances was to be completed, resulting in a letter to management highlighting the work done, auditors' findings and areas for further work.



17. The opening balance sheet and supporting documentation was not passed to external audit for review by the deadline date of 28 November 2008. Provision of the restated balance sheet was delayed because of the resource requirement to review estates related leases and agreements and as a result, we were unable to complete our dry-run audit of opening balances. As at 28 February 2009, extensive work has been undertaken on the opening balance sheet however a number of areas have not yet been finalised including:
- **Timber stocks** – techniques for the measurement of the value of inventories have been developed for application across the Forestry Commission group and are under discussion with individual finance teams.
 - **Forest Holidays** – review work has been completed and proposals submitted to NAO (as lead auditor for this area).
 - **Leases** – review of lease terms is ongoing.
 - **Annual leave accrual** – IFRS specifically require accounts to include the level of untaken leave at the financial year end.
18. The work to prepare for the next stage of IFRS implementation is almost complete and FES intend to issue shadow IFRS accounts by 30 September 2009, in accordance with the Scottish Government timetable. In view of the earlier delay in provision of the restated balance sheet, we now intend to review both the opening balances and shadow accounts together.



Use of Resources

19. Sound management and use of resources (people, money and assets) to deliver strategic objectives is a key feature of best value. We consider aspects of use of resources as part of our audit and this section sets out the main findings from our review of FES

- financial position
- financial management
- management and use of information and communications technology (ICT).

Financial Position

Outturn 2008/09

20. FES is an executive agency of Forestry Commission Scotland (FCS), and manages the forest estate on behalf of the Scottish Ministers. The Income and Expenditure Statement for 2008/09 shows a net deficit, after cost of capital of £31.5 million (2007/08 £30.8 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 £26.9 million, a decrease of £8.2 million compared to the previous year. The decrease is attributable mainly to a reduction in capital expenditure.

21. The most significant costs for the year were harvesting and haulage of timber (£20.2 million), forest protection and maintenance (£18.1 million) and forest roads (£12.3 million), where expenditure was in line with the previous year.

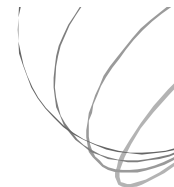
22. Income from sales of timber was £37.3 million, a decrease of £4.8 million on 2007/08, due the downturn in the UK economy.

23. FES Balance Sheet at 31 March 2009 shows total net assets of £49.490 million (2007/08 £55.209 million). The decrease is attributable mainly to the 2008/09 revaluation of Dwellings and Other Buildings which resulted in a decrease of £4.8 million.

Financial sustainability and the 2009/10 budget

24. Scottish Ministers have agreed budgets for Forestry Commission Scotland of £93.8 million for 2008/09 which includes Forest Enterprise deficit funding of £23.6 million.

25. Papers to the FES Management Board have highlighted the main risk to achieving the resource budget as ability to generate income from timber sales and other development opportunities in the forest estate.



26. In order to ensure that the financial position is monitored effectively, cashflow forecasts are presented regularly to the Management Board which track income/expenditure and cashflow during the year (actual and forecasts). The main drivers such as timber income and volumes are captured monthly. The Management Board is updated within a month of period end.
27. We will continue to monitor the financial position and the actions taken by FES to manage this risk.

Financial management

28. In our Final Report for 2007/08, we recorded that from April 2008, FCS (including FES) introduced 'Accounting by Objectives' into its financial planning system. This meant that the organisation will capture costs by Scottish Forestry Strategy objectives which will summarise to country outcomes, and also an automatic link to the Scottish Government's strategic objectives.
29. A number of issues arose during the initial implementation of this system in 2008/09 around data quality. These issues are to be addressed during 2009/10 whilst implementing Phase 2 of the project which involves the purchase of new hardware to host the business planning models. A joint project team and steering group is to decide on the enhancements to be implemented and the future direction of the planning model. This is a further important development and one which we will keep under review during our appointment.

Management and use of ICT

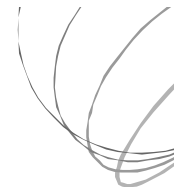
30. As part of the 2008/09 audit we have reviewed the following aspects of FES management and use of ICT:
 - compliance with information governance standards
 - payroll.

Compliance with information governance standards

31. The Information Management Security Forum (ISMF) is chaired by the Director General and the Forestry Commission Executive Board with coordinating and controlling the implementation of information security for the Forestry Commission. The Director Finance (GB) is Senior Information Risk Officer (SIRO) and chairs the ISMF which meets on a monthly basis. The work of the ISMF is supported by the departmental security officer and the IT security officer. The devolved administrations including Scotland take forward their own actions.



32. The report on a Data Handling Review published in June 2008 for the UK public sector set down mandatory requirements for all departments and agencies in four main areas:
- standardising data security roles
 - making departments more disciplined in handling the public's personal data
 - introducing obligatory protective measures such as encryption and penetration testing
 - increasing security arrangements
33. Considerable progress has been made by Forestry Commission UK against the mandatory requirements, particularly in relation to the standardisation of data security roles. However, the SIRO has reported to the Forestry Commission Executive Board and agency accountable officers that the following issues require to be addressed:
- no cohesive business continuity plans exist for the loss of information services
 - formal documentation is either lacking or needs updating for most business areas
 - managing updates for all applications and operating systems versions requires improvement
 - there is a lack of monitoring over information systems.
34. There were no reportable incidents of personal information data loss during the year. However on 5 December 2008, a severe loss of IT service occurred within forestry affecting 17 servers within Information Services and 16 PCs/laptops within Silvan House. This caused a number of systems to fail including the e-financials system. It took 5 days to recover the main e-financials service and a further month to restore all services around e-financials. FC has carried out an investigation into the incident and a Service Loss report dated 3 April was prepared.
35. The report contains 17 recommendations to address major weaknesses within FCUK. These include:
- systems not being fully backed-up and lack of restore testing
 - lack of documented procedures
 - lack of disaster recovery and business continuity management including co-ordination and responsibilities and plans.
36. The Director of Information Services has agreed an action plan for the main recommendations with the IS Service Board. We intend to keep this topic under review and will continue to monitor progress in implementing the recommendations within FES.



Payroll system review

37. As part of our risk based assessment of Forestry Commission, we identified the REBUS Payroll system as a priority area for review. Our audit work was carried out during February and March 2009. This involved assessing an application system review programme (ASR) completed by management, and interviews with key staff. The ASR provides a high-level risk based assessment of the Payroll system, and in particular the key IT controls within the system.
38. Our overall conclusion is that the Payroll system is operating well and provides assurance on the accuracy and completeness of management information. In particular, we identified a number of areas of good practice during our review, including:
- a small, dedicated team responsible for the day to day support of Payroll
 - a formal managed services agreement with Northgate Arinso for maintaining the system
 - good data integrity controls including the running of numerous test payrolls throughout the period to ensure complete and accurate data prior to running the live payroll.
39. During our review, we identified areas where improvements can be incorporated into current operational practice, in particular by:
- reinforcing key controls in the Payroll procedural manual to staff
 - controlling and monitoring user access accounts
 - driving business continuity planning throughout Forestry Commission.
40. We will monitor progress made against those areas identified for improvement as part of our 2009/10 work.

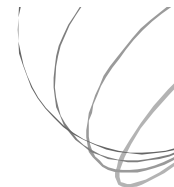
National Studies

41. Audit Scotland published three national studies relevant to FES use of resources. These were use of consultancy services, improving energy efficiency and improving public sector purchasing.



Use of consultancy services

42. The overall aim of the study was to review central government's use consultancy services and to make recommendations to improve the public sector's use consultants' knowledge, skills and resources to help deliver new services and initiatives quickly and expertly. The key findings were as follows:
- The public sector is strengthening the way it buys goods and services.
 - Central government does not have a clear strategy for its use of consultants or for linking use to its priorities or financial and workforce plans.
 - In most cases, central government buys consultancy services well but some improvements can be made.
 - Central government could improve how it manages consultancy projects through more consistent and formal evaluation of consultants' work and learning more from them.
 - Central government could make savings of up to £13 million a year through better planning and buying of consultancy services.
43. The report made specific recommendations for public bodies:
- confirm they have clear processes for approving and recording the use of consultants and monitoring progress, and reinforce these as required
 - plan their use of consultancy services when developing their forward work programme to ensure that consultants are used where their knowledge and skills bring greatest value for money
 - always evaluate the option to use consultants against the option to use their own staff
 - increase the use of framework agreements where possible by ensuring that existing agreements are used and new ones developed as appropriate
 - evaluate the work of consultants more systematically and share findings from these reviews
 - work closely with consultants to increase assurance on quality and make use of opportunities to learn from consultants and ensure knowledge transfer, where appropriate.
44. The report has been reviewed by Forestry Commission senior management who have concluded that the current procurement processes and procedures in place were sufficient to ensure that the use of consultants within FES is appropriate and provides value for money.



Improving energy efficiency

45. Audit Scotland assessed how councils, NHS bodies and central government bodies were improving energy efficiency in relation to buildings and transport use. This included examination of a range of issues including whether public bodies demonstrate commitment to improving energy efficiency; how public bodies are performing against their objectives and targets for improving energy efficiency; and if public bodies are delivering continuous improvement in this area. We reported that:
- Funding has been made available by the Scottish Government and public bodies to improve energy efficiency.
 - There is a need for stronger leadership by the Scottish Government and within public bodies to improve energy efficiency and ensure that the necessary cultural and behavioural changes are made.
 - A robust strategy is central to the coordination of activities to improve energy efficiency, however, there are inconsistencies in the quality of strategies being implemented
 - There is a lack of formal monitoring and reporting of progress in improving energy efficiency by public bodies and the Scottish Government.
46. In addition to their role in tackling the effects of climate change through the Climate Change Action Plan, FCS (including FES) has made a number of contributions to improving energy efficiency in relation to buildings and transport use. In particular:
- The new Inverness Forest District Office was officially opened in 2007 as the first truly “green” building on the national forest estate. The building uses locally harvested woodchip to provide heating, volcanic rock as insulation and a natural ventilation system rather than an electrically powered one. With this model now being rolled out across all office refurbishments.
 - The Scottish Forestry Strategy, as part of its 2010-2012 outline programme, includes the requirement to investigate efficient and cost effective options for reducing the environmental impact and net cost of transporting timber.
 - A key agency target is to reduce carbon emissions from administrative travel by 5% annually.

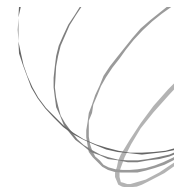


Improving public sector purchasing

47. Audit Scotland assessed the impact of the Public Procurement Reform Programme (the Programme) which aimed at improving purchasing practice and making savings of about three per cent a year. This included examination of the savings from the Programme and the wider benefits of the Programme. The report noted the following:

- The Programme which is ambitious and challenging has made significant progress but some changes are taking longer than planned to implement and performance measures are largely incomplete.
- Around £327 million has been saved in the first two years of the Programme which is in line with the Programme target however some savings have been delayed and because of limited data it is unclear how progress towards the third year target of £400 million will be monitored.
- Overall the impact of the Programme appears positive however the scale of improvement is difficult to quantify and there are variable levels of engagement by public bodies.
- Key risks to the Programme include maintaining momentum, programme management, availability of information and shortages of skilled staff. These need to be addressed to help accelerate the Programme.

48. The report is currently being reviewed by Forestry Commission senior management to access procurement arrangements. We are aware that the national forestry procurement team liaise with the Scottish Government Procurement Team, as well as the Welsh Assembly Procurement Team and the Office of Government Commerce to assist in delivery of best value from spending.



Governance and Accountability

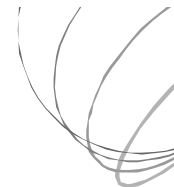
49. High standards of governance and accountability, with effective structures and processes to govern decision-making and balanced reporting of performance to the public, are fundamental features of best value. This section sets out our findings arising from a review of FES arrangements.
50. Increasingly services are being delivered across the public sector through partnership working, sometimes involving complex governance and accountability arrangements. Best value characteristics also include effective partnership working to deliver sustained improvements in outcomes.

Overview of arrangements

51. This year we reviewed:
 - partnership working
 - shared services and common account areas
 - key systems of internal control
 - internal audit
 - arrangements for the prevention and detection of fraud and irregularity, including standards of conduct.
52. Our overall conclusion is that arrangements within FES are sound and have operated through 2008/09.

Partnership working

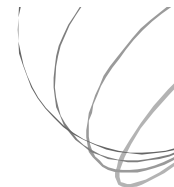
53. In June 2007 Ministers challenged the organisations delivering the rural affairs and environment portfolio to create a single environment and rural delivery service (SEARS). SEARS brings together nine delivery-focused bodies within the Environment and Rural Affairs sector to provide more joined-up services, initially to rural land managers. FCS (including FES) is a member of the SEARS partnership.
54. SEARS is a partnership approach and it is therefore vital that the SEARS partners have a clear understanding of their responsibilities, with clear lines of accountability. To ensure this a memorandum of agreement, setting out the framework for the partnership, was agreed by the SEARS Programme Board in March 2008.



55. SEARS is a commitment to working in a joined-up way. The Annual Review 2008/09 notes that during the first year since the partnership was launched it has:
- carried out 2,000 fewer inspections or visits to land managers ahead of the October 2009 target
 - saved the sheep farming industry around £150,000 in groundwater license charges through SEPA waiving the second instalment of the annual charge for 2008/09
 - introduced a 24/7 contact centre and established the SEARS web portal
 - given land managers the opportunity to change their personal information with the nine bodies within the Environment and Rural Affairs sector through single contact, thereby reducing duplication
 - improved the co-ordination of communication between the SEARS partners
 - co-located SNH, SGRPID and FES, along with staff from Highlands & Islands Enterprise and Community Energy Scotland in new office in Golspie.
56. SEARS is currently exploring other areas for further development, including shared services, co-locations and linking the natural and built environment.

Shared services and common account areas

57. The structure of the Forestry Commission Audit has changed in recent years due to the devolution settlement across Scotland and Wales. This has made the administration of the Forestry Commission more complex, with a similar impact for the audit process across the three external audit bodies.
58. The audit 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, taking assurance from the Quality Assurance arrangements operated centrally by Audit Scotland
 - observe the public interest by delivering an efficient co-ordinated audit which avoids unnecessary duplication and expense
 - 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 appear to the client to be seamless and integrated, resulting in a consistent audit view on accounting matters.
59. We carried out audit testing and provided assurance as agreed in detail with the other audit agencies for the 2008/09 accounts.



Systems of internal control

60. 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 2008/09 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.
61. As part of our audit we reviewed the high level controls in a number of FES systems that impact on the financial statements. This audit work covered shared account areas and linked common systems at Forestry Commission Headquarters in Edinburgh as outlined at para 59 above. Our overall conclusion was that key controls were operating effectively and that Forestry Commission has adequate systems of internal control in place. Our review did identify a number of areas for improvement which were reported to relevant officers in June 2009. We will monitor progress made against those areas identified for improvement as part of our 2009/10 work.
62. We also reviewed, in conjunction with the FES Inspections Team, a number of systems in place at Forest Districts in Scotland which impact on the financial statements. Our overall conclusion was that key controls were operating effectively and that FES has adequate systems of internal control in place. Our review did identify an error relating to compensation felling income and a number of areas for improvement were reported to relevant Forest District Managers in April 2009. We will monitor progress made against those areas identified for improvement as part of our 2009/10 work.

Statement on Internal Control

63. The Statement on Internal Control provided by the Agency 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 approach to this. Attention was drawn to a number of risks requiring attention for 2009/10. These are:
- **Reduction in income** – The economic downturn might restrict FES's ability to generate income, notable from timber sales. Any shortfall in income that cannot be compensated by other income would restrict FCS's ability to deliver the Scottish forestry Strategy.
 - **Shared services** – The governance and funding of these services is under review to ensure that they can meet customers' needs.
 - **IFRS** – Forestry Commission has found it difficult to meet the timetable for the introduction of IFRS. Work will be planned and monitored closely during 2009/10 to ensure full compliance.



64. These risk areas are complex and comprise multiple issues. We will continue to monitor progress in managing these areas during 2009/10

Internal Audit

65. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2008/09 audit we assessed whether we could place reliance on the internal audit function. We concluded that the internal audit service operates in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in number of areas during 2008/09, as we anticipated in our annual audit plan.
66. Revised Government Internal Audit Standards have been introduced from April 2009. Compliance with standards is also subject to independent confirmation via External Quality Assurance (EQA) reviews. The next EQA review for Forestry Commission is due in early 2010.

Prevention and detection of fraud and irregularities

67. FES have appropriate arrangements in place to prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and Board members.

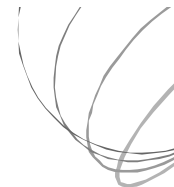
National Studies

68. Audit Scotland published one national study relevant to FES use of resources. This was a review of major capital projects.



Major capital projects

69. This report was the first systematic review of major capital projects in Scotland. It considered the progress of all 43 projects completed in the five years between April 2002 and March 2007, and a sample of current major projects. It looked at progress against cost and time estimates, quality specifications and project management in general. The main findings from the report were as follows:
- In general, the achievement of cost and time targets improved significantly as projects progressed.
 - Early cost and time estimates at project approval stage were too optimistic for many major projects.
 - Performance against cost and time estimates is better after contracts are awarded, as plans are more certain and risks clearer.
 - Most completed projects have successfully delivered the required roads, hospitals and other assets, and all current projects are forecast to do so. However, few projects have been evaluated to demonstrate that they have delivered the expected wider benefits which originally justified the investment.
 - Nine current projects examined had awarded the main construction contract, which should increase cost certainty. However, four projects had significant increases in estimated cost before reaching this stage.
 - Project management and governance arrangements within individual projects are broadly effective, although room for improvement remains. A more strategic approach to managing the programme of capital projects could improve value for money.
70. This report has been reviewed by Forestry Commission senior management who have concluded that the current project management and governance arrangements in place are sufficient to ensure that value for money is achieved in all capital projects.

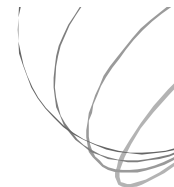


Performance

71. 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. Key features of best value include:
- setting a clear vision of what the organisation wants to achieve, backed up by plans and strategies to secure improvement, with resources aligned to support their delivery
 - a performance management culture which is embedded throughout the organisation and a performance management framework which is comprehensive and supports the delivery of improved outcomes.
72. In this section we comment on:
- corporate plan
 - performance against targets
 - risk management arrangements
 - efficiency programme.

Vision and strategic direction

73. The FCS (including FES) corporate plan for 2008 – 2011 plan records that the Scottish Forestry Strategy is the framework for taking forestry forward through the first half of the century and beyond. The plan also uses the seven themes identified in the strategy (see para 61) to identify priorities and set out the specific actions which FCS is taking over the period 2008-2011 to help achieve this vision. FES will play a key role in delivering the Strategy.
74. The FES Framework Strategic Plan for the National Forest Estate defines how FCS will use the estate to implement the Strategy and what actions it requires from FES. It also provides direction for the Forest District Strategic Plans which are cascaded down to individual Forest Design Plans.
75. The corporate plan records that the difficulties inherent in measuring outcomes such as improved health and well being are significant and targets have not been set for each of the key objectives over a specified period. FES have specific Key Agency Targets developed from the range of key performance indicators included in their Framework Document. These are included in the FCS Annual Report and Accounts and are discussed at para 79 below.



76. During 2008, FES completed a review of their organisation which has resulted, from 1 April 2009, in a revised structure at forest district level. The purpose of the review was to ensure that FES is able to operate effectively and deliver a wide range of social, economic and environmental forestry policies. The review has resulted in a reduction in the number of forest districts across Scotland from 14 to 10 by adjusting the management structure and geographical boundaries that each forest district will cover

Performance overview – key performance indicators

77. Seven key agency targets were set by the National Committee for Scotland for 2008/09 for FES. These targets were generally achieved however performance results against agreed financial targets and unit costs were mixed. By way of example:
- the volume of wood harvested in relation to the sales plan (2,853 km³) was some 13% less than target (3,285 km³)
 - total direct production unit cost (excluding haulage) of £12.52 per m³ was outwith the target of £11.50 per m³
 - the cash deficit for the year of £26.9 million was an improvement on the target of £28.4 (+/- 1%) million.

Risk management

78. From 2009/10, Risk registers are formally reviewed by the FES Management Board and updates on risk management are formally reported to the Audit and Risk Committee throughout the year, in line with their terms of reference. An updated risk register was considered and approved by members of the FES Management Board in March 2009. This was preceded by a separate review undertaken by a range of managers from across the organisation who considered the content of each register, individual risk scores and the adequacy of the control framework.
79. The FC wide Risk Management Group met in March 2009 to consider and share action taken in embedding risk management in each part of FC, including Scotland. The Group revisited FC's overarching Risk Policy Statement and agreed an update. FES has its own Policy Statement which is drawn from the main FCGB version.

Efficiency

80. For 2009/10 and 2010/11, FCS (including FES) is required to make contribution to a 2% per annum cash releasing efficiency saving for the Rural Affairs and Environment portfolio. The 2% efficiency represents in the region of £2 million per annum for FCS. The FCS Delivery Plan for the 2008-11 Efficiency Programme records that it plans to sell those assets delivering least against Scottish Government objectives and reinvest the income (in excess of £10 million per annum for three years) on buying land and planting trees that better meet Scotland's needs. Disposals and acquisitions are managed by FES but are held on FCS accounts.



81. The Delivery Plan also records that although FCS plan to sell around £15 million of assets per annum, there are risks attached to the programme which will arise from market conditions and also their ability to purchase and plant appropriate land using these released funds. Indeed, the Rural Affairs and Environment Committee in its report on the Scottish Government's Draft Budget for 2009/10, noted that the planned sale may not result in the level of capital receipts anticipated by FCS and hoped to be kept up to date on any developments in relation to this matter.

82. FES has highlighted the main risk to achieving financial balance as its ability to generate income from timber sales and other development opportunities in the forest estate. We will continue to monitor the financial position and the actions taken by FES to manage this risk.



Looking Forward

83. FES faces a number of challenges in 2009/10, which include:

- **Efficiencies and future funding** - Budgets for 2009/10 and the immediate future will need to be managed within a tighter funding regime. This includes no scope for the application of end of year flexibility for the Government with HM Treasury until the next Spending Review; no option to transfer funds from capital to revenue; and the impact of the introduction of International Financial Reporting Standards (IFRS), particularly on leases and infrastructure accounting. For 2009/10 and 2010/11, FCS (including FES) is required to make contribution to a 2% per annum cash releasing efficiency saving for the Rural Affairs and Environment portfolio. The challenge for FCS is to prioritise spending, identify efficiencies and review future commitments to ensure delivery of key targets and objectives
- **IFRS**- The timetable for IFRS implementation requires that central government accounts in Scotland to become IFRS compliant with effect from the 2009/10 financial year. As part of the timetable for the implementation for IFRS, shadow accounts will require to be produced for 2008/09 for audit review by 30 November 2009. These processes will require significant resource to complete and it will be important that these issues are addressed early in 2009/2010.
- **Reduction in income** –With the recent slowdown in the British economy, the close link between the construction and the timber processing sectors led to very rapid knock-on impacts, with many mills having to reduce throughput. This impact has spread back up the supply chain to the haulage and forest management sectors. The economic downturn might restrict FES's ability to generate income, notably from timber sales. Any shortfall in income that cannot be compensated by other income would restrict FCS's ability to deliver the Scottish forestry Strategy.
- **National Performance Framework** - The Scottish Government is continuing to develop its approach to performance management based on the National Performance Framework and local authority single outcome agreements. This is an outcome-based approach that is reported to the public on the Scottish Government's web site in the 'Virginia-style' model of performance measurement and reporting. This will include progress on overall delivery of the administration's purpose for Government, the five strategic objectives for Scotland and other aspects of the outcomes. FES will need to consider the impact of this developing area.