

Accounts for the year ended 31 March 2006



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Annual Report For the year ended 31 March 2006

1. Basis of accounts

These accounts are prepared in accordance with a direction given by HM Treasury in pursuance of section 7 of the Government Resources and Accounts Act 2000.

Management commentary

2. Status

Forest Research became an Executive Agency of the Forestry Commission on 1 April 1997. It undertakes the major part of the Commission's research and development programmes as well as providing survey, monitoring and scientific services.

Forest Research remains part of the Forestry Commission, which is a cross border Government Department responsible for forestry throughout Great Britain. The relationship between Forest Research, the Forestry Commissioners and Forestry Ministers is described in the Framework Document, revised and published in September 2003.

Prior to April 1997, Forest Research was managed as a Division of the Forestry Commission and its assets and financial transactions were included in the departmental accounts presented in the Forestry Commission Annual Report and Accounts.

From 1 April 1997, the Agency assumed ownership of and responsibility for the assets and liabilities appropriate to the research activity, which were included in the Forestry Commission Statement of Assets and Liabilities as at 31 March 1997. It also assumed ownership of the building assets it occupies, which were previously owned and managed on behalf of the Forestry Commission by the Forest Enterprise agency, with appropriate intra-departmental charges made, and recorded on the Forest Enterprise balance sheet as at 31 March 1997.

Two organisational reviews took place during 2002 and 2003 that impacted on the Agency's status and operational arrangements.

In line with normal arrangements for agencies, Forest Research underwent a Quinquennial Review, stage one of which was completed in January 2002, whilst between May 2001 and August 2002 an interdepartmental group carried out a review of the Forestry Commission. This reviewed the devolution arrangements for delivering sustainable forestry policies in England, Scotland and Wales and the UK's international forestry commitments.

On conclusion of stage one of the Forest Research Quinquennial Review, Forestry Ministers decided that the Agency should retain its executive agency status for a further five years. The devolution review concluded that Forest Research should continue as a GB-wide agency of the Forestry Commission but new arrangements should be set up, with an enhanced role for the devolved administrations through the National Offices in England, Scotland and Wales in determining research priorities and specifying programmes.

The stage two report of the Agency's Quinquennial Review, which addressed the issues on implementing the outcomes of the stage one review and the devolution review, was approved by Ministers and a new Framework Document was put in place in September 2003.

Under the Framework Document, Forest Research is funded from the sale of its services to both the Forestry Commission and external customers. Any annual surplus or deficit is counted in the Forestry Commission's net funding requirement.

Forest Research has been designated a GB entity. For Resource Accounting purposes Forest Research is within the departmental boundary. Its accounts are consolidated into the Forestry Commission England/GB accounts.

3. Strategy

The strategic aims and objectives of the Agency have been set to assist the Forestry Commission achieve its GB objective to take the lead in development and promotion of sustainable forest management and to support its achievement nationally.

These are discussed in detail in the Agency's corporate plan, which will be available on the Forestry Commission website and the Forest Research website.

4. Relationships with stakeholders

As most aspects of forestry are devolved activities, strong relationships between the wider Forestry Commission (FC) and the devolved administrations are critical. Summer 2005 saw the launch of FC's Science and Innovation Strategy, with an increased focus on the role of the FC National Offices and the Northern Irish Forestry Service to shape the research agenda and to disseminate results. Consultations associated with this process involved the participation of many of our key stakeholders, focused around meetings held during the year. The Agency subsequently appointed three Regional Liaison Officers, to support the process of research commissioning and dissemination on an ongoing basis.

As an applied research institute, the Agency's relationships with the forestry and land management industries are also of paramount importance. The Agency has recently strengthened its industrial links in a number of ways.

- The strengthening of its knowledge transfer expertise, through monies awarded by 'Public Sector Research Establishment 3' innovation capacity building fund, is enabling the Agency to take a more pro-active role in industry-led innovations.
- The Agency has become a member of the English Forest Industries Partnership, which has just completed a sector mapping study.
- The Agency's close association with the Scottish Forest Industries Cluster has resulted in full involvement in the development of the European Forestry Technology Platform and its associated strategic research agenda, which will be taken forward in the Framework 7 programme during 2007–2013.

5. Aims and objectives

The aim of Forest Research is set out in the Framework Document. It is to support and enhance forestry and its role in sustainable development, by providing high quality research and development in a well-run organisation.

The objectives of Forest Research are listed on page 4 in the Annual Report.

Current and future development and performance

6. Operating review

The year proved to be one requiring continuing flexibility in deployment of resources as requirements for work on key areas such as Phytophthora developed during the year.

The year saw the Agency's first involvement in the Scottish Native Woodland Survey and it is expected that this pilot work will lead to a substantial programme of activity over the coming years.

In line with policy to increase the value of and expand the range of involvement in non-FC funded research, the development of initiatives in sustainability forestry such as woodfuel and biomass energy, as well as land regeneration and remediation, have progressed apace. These are confidently expected to bear fruit in future years.

The successful bid for PSRE funding, which yielded £495,000 over a three-year period, will enable the Agency to accelerate the construction of its commercialisation and innovation skill base in order to pursue the government agenda for exploitation of science.

Changing requirements for fieldwork and traditional experiments have led to a steady and increasing downturn in the financial performance of the Technical Support Unit (TSU). A thorough study, conducted over the past two years, concluded that the TSU was no longer sustainable in its present size or organisation but remained a valuable asset to the Agency and the Commission as a whole.

Restructuring plans were prepared, involving a number of early retirements and redundancies, and these were approved for implementation during 2006–07. The costs will be met from the Agency's own resources and provision has been made in the 2005–06 accounts (see note 17, page 99).

7. Financial review

This is Forest Research's ninth year of operation as an Agency. Forest Research produced a net operating surplus of £460,000 on its Income and Expenditure Account, excluding the notional cost of capital and before an exceptional item reflecting the provision made in respect of the costs of TSU restructuring, which will fall due in 2006–07 and subsequent years. A comparison of income and expenditure with the previous year's results shows that:

- staff costs increased by £516,000 (6.1%)
- other management costs by £88,000 (4.0%)
- materials and services costs increased by £77,000 (2.9%)
- income from Forestry Commission customers increased by £859,000 (7.5%)
- income from external customers reduced by £100,000 (4.7%)
- the notional cost of capital increased by £32,000 (7.8%)
- the exceptional item represents the provision for the costs of restructuring (£369,000) being the present values of the costs of early retirements and redundancy payments falling due in 2006–07 and beyond.

The net surplus for the year after the cost of capital charge of £441,000 and depreciation was £19,000, representing a cost recovery rate of 100.1%. After providing for restructuring costs the net deficit for the year was £350,000.

After adjusting the total deficit for items not involving the movement of cash and for capital expenditure, bank account movements and income, the net cash inflow for the year was £217,000, which was handed over to the Forestry Commission.

Additions to fixed assets in the year were £489,000.

8. Financial objective – Key Performance Indicators (KPIs)

Forest Research's primary financial objective set out in the Framework Document is to recover the full economic costs, including cost of capital, of its operations from the sale of services to customers. In 2005–06, measured before the provision for restructuring costs, this objective was met with a full cost recovery rate of 100.1%.

Performance against other operational, scientific and financial KPIs is reported in the main body of the Annual Report and Accounts. The KPI to achieve £1.9m from income from non-FC customers was exceeded by £0.1m. There are two other financial KPIs relating to the overall cost per chargeable research day and the cost of support services per chargeable research day. Following the internal restructuring of the Agency in 2004–05 efficiency savings have been achieved against both of these KPIs with the overall cost measure reducing by 6% and support services reducing by 11%.

9. Events since the balance sheet date

The Technical Services Unit restructuring plan was implemented and the formal notice to the nine staff of redundancies/early retirements were issued in April 2006 with effective dates in October 2006. These events have been provided for in the 2005–06 accounts and presented as an exceptional item in the Income and Expenditure account.

10. Future events

As a science-based government agency, FR staff are part of the wider science and technical development community maintaining world class expertise and excellence in applied forest research. Three of the key priorities for FR in the coming year will be:

- to increase our partnerships with other research establishments, across the UK, Europe and worldwide – linking with programmes of research, development, monitoring, resource evaluation and scientific services;
- to establish relationships with users of research outputs including industry, policymakers and other stakeholders in order to understand their needs;
- to monitor bodies that fund research in order to be responsive to changing needs.

FR will continue to lead research in areas of sustainable forestry which increasingly cut across its programmes and which include social, economic and environmental components. FR continues to grow as an internationally recognised centre of excellence in the traditional area of advancing the scientific understanding of sustainable forest management. However, it is also extending this reputation in areas which include research into all aspects of the environment pertaining to trees, woodlands, forests and on their value to society.

There will be continued emphasis on knowledge transfer. There will be increasing analysis of the existing routes for knowledge transfer including further development of the website. The three Research Liaison Officers (RLOs) now in place in England, Scotland and Wales lead in establishing and maintaining channels of communication with stakeholders and in developing new initiatives for improving knowledge transfer.

Other disclosures

11. Supplier payment policy

Forest Research observes the principles of the Late Payment of Commercial Debts (Interest) Act 1998. Unless otherwise stated in the contract, we aim to pay within 30 days from the receipt of goods and services, or the presentation of a valid invoice, whichever is the later. An analysis for 2005–06 indicates that 99.92 % of payments to suppliers, including those made using the Government Procurement Card, were paid within the due date. Arrangements for handling complaints on payment performance are notified to suppliers on orders. No interest was paid under the Late Payment of Commercial Debts (Interest) Act 1998.

12. Employment policies

Forest Research adheres to the Forestry Commission's employment policy and values and respects its staff by treating each member with respect and trust, and in doing so recognises that each person is different and can make a unique contribution to the work. The purpose of the Forestry Commission's employment policy is to demonstrate that it is an equal opportunity employer and the aim is to be fair to everybody. To do this the Forestry Commission ensures that no eligible job applicant or employee receives less favourable treatment on the grounds of their gender, or gender re-assignment, ethnic origin, disability, age, nationality, national origin, sexual orientation, marital status, religion and religious or philosophical belief, social class or offending background.

All employees, whether part-time, full-time or temporary will be treated fairly and equally. Selection for employment, promotion or training or any other benefit will be on the basis of aptitude and ability. All employees will be helped and encouraged to develop their full potential and the talents and resources of the workforce will be fully utilised to maximise the efficiency of the organisation. No person shall be disadvantaged by conditions or requirements which cannot be shown to be justifiable.

The Forestry Commission also follows good employer practices aimed at ensuring that all staff work in an environment free from both illegal and unfair discrimination and harassment. Consolidated statements of the Commission's obligations with regard to equality of opportunity and diversity are shown in the Staff Handbook. Full details of these initiatives arising from our policies are also set out in the Human Resources intranet site.

The Forestry Commission will monitor the success of its policies by:

- Collecting and analysing data as appropriate.
- Regularly reviewing procedures (recruitment, performance management, promotion and pay) to ensure that they are free of unfair discrimination.
- Reporting the results of equality and diversity monitoring to the Human Resources Management Sub-Committee on an annual basis.
- Liaising closely with Cabinet Office and other Government Departments to ensure that we are keeping abreast of all changes in legislation and other developments.

Further information on the employment of persons with disabilities, the provision of information to, and consultation with, employees, and the promotion of equal opportunities is available on request from the Human Resources unit of the Forestry Commission.

13. Management

The Ministers who had responsibility for the Forestry Commission, including Forest Research, during the year were:

Rt. Hon. Margaret Beckett MP	<i>Secretary of State for the Department for Environment, Food and Rural Affairs</i>
Ben Bradshaw MP	<i>Parliamentary Under Secretary (Commons), Department for Environment, Food and Rural Affairs (until 12 May 2005)</i>
Jim Knight MP	<i>Parliamentary Under Secretary (Commons), Department for Environment, Food and Rural Affairs (from 13 May 2005)</i>

Members of the Management Board of Forest Research during the year were:

Jim Lynch	<i>Chief Executive</i>
Peter Freer-Smith	<i>Research Director</i>
Ken Charles	<i>Head of Human Resources and Administration</i>
Tony Cornwell	<i>Finance and IT Director</i>
Hugh Evans	<i>Head of Tree Health Division</i>
Sam Evans	<i>Head of Biometrics Division</i>
Bill Mason	<i>Head of Forest Management Division</i>
Andy Moffat	<i>Head of Environmental and Human Sciences Division</i>
Chris Quine	<i>Head of Ecology Division</i>
Xanthe Christophers	<i>Communications Director</i>

The Chief Executive is appointed on a fixed term basis following public advertising of the post. The term of the appointment, and provision for its termination, are governed by the Civil Service Commissioners' Recruitment Code.

Remuneration of board members who hold senior staff group posts is determined by the Forestry Commission's Senior Pay Committee in accordance with guidelines prescribed by the Cabinet Office. Other board members' remuneration is determined by the standard processes set out in the Forestry Commission's pay and grading system.

Further details on remuneration are set out in the Remuneration Report.

14. Pensions

Information on pensions is contained in the Remuneration Report and accounting policy note 1.14.

15. Auditors

These accounts are prepared in accordance with a direction given by the Treasury in pursuance of Section 7 of the Government Resources and Accounts Act 2000. They are audited by the Comptroller and Auditor General. The fee for statutory audit services in respect of these accounts was £22,500. No further assurance or other non-audit services were provided.

16. Disclosure of audit information to the auditors

So far as I am aware, there is no relevant audit information of which the Forest Research auditors are unaware. I have taken all the steps that I ought to have taken to make myself aware of any relevant audit information and to establish that the Forest Research auditors are aware of that information.

Professor J.M. Lynch

Chief Executive and Agency Accounting Officer

13 July 2006

Remuneration Report

Remuneration policy

Remuneration of board members who hold senior staff group posts is determined by the Forestry Commission's Senior Pay Committee in accordance with guidelines prescribed by the Cabinet Office. Details of membership of the Pay Committee are provided in the Remuneration Report of FC Great Britain/England. Other board members' remuneration is determined by the standard processes set out in the Forestry Commission's pay and grading system.

Employment contracts

The Chief Executive is appointed on a fixed term basis following public advertising of the post. The term of the appointment, and provision for its termination, are governed by the Civil Service Commissioners' Recruitment Code. Jim Lynch was appointed Chief Executive on 1 July 2003 on a five-year contract which expires on 30 June 2008.

Civil Service appointments are made in accordance with the Civil Service Commissioners' Recruitment Code, which requires appointment to be on merit on the basis of fair and open competition but also includes the circumstances when appointments may otherwise be made.

Other than the Chief Executive the senior staff covered in this report hold appointments which are open-ended until they reach the normal retiring age. Early termination, other than for misconduct, would result in the individual receiving compensation as set out in the Civil Service Compensation Scheme.

The performance of senior staff is monitored and reviewed through the appropriate Performance Monitoring System (PMS) of the Forestry Commission. No element of remuneration is specifically subject to performance conditions although pay progression can be affected and performance bonuses, if awarded, are based on remuneration.

Further information about the work of the Civil Service Commissioners can be found at www.civilservicecommissioners.gov.uk

Salary and pension entitlements

The salary and pension entitlements of the members of the Forest Research Executive Board were as follows.

	2005-06		2004-05	
	Salary £000	Benefits in kind (to the nearest £100)	Salary £000	Benefits in kind (to the nearest £100)
Jim Lynch	80-85	-	80-85	-
Peter Freer-Smith	65-70	2,000	60-65	1,600
Ken Charles	45-50	-	45-50	-
Tony Cornwell	45-50	-	40-45	-
Bill Mason	50-55	-	50-55	-
Sam Evans	45-50	-	40-45	-
Hugh Evans	55-60	1,300	55-60	300
Chris Quine	50-55	-	45-50	-
Andy Moffat	55-60	-	50-55	-
Xanthe Christophers (joined Board July 2005)	40-45	-	40-45	-

Salary

'Salary' includes basic salary, performance pay or bonus, overtime and any allowances subject to UK taxation.

Benefits in kind

The monetary value of benefits in kind covers any benefits provided by the employer and treated by the Inland Revenue as taxable income. They are in respect of the Car Provision for Employees Scheme.

Pension benefits

Name	Real increase in pension and related lump sum	Total accrued pension at age 60 and at 31/3/06 and related lump sum	CETV @ 31/3/05	CETV @ 31/3/06	Real increase in CETV after adjustment for inflation and changes in market investment factors	Employer contribution to partnership pension account including risk benefit cover
2005-06	£000	£000	£000	£000	£000	£
Jim Lynch	0-2.5	2.5-5	42	76	25	-
Peter Freer-Smith	0-2.5 plus 2.5-5.0 lump sum	17.5-20 plus 55-57.5 lump sum	248	340	21	-
Ken Charles	0-2.5 plus 0-2.5 lump sum	17.5-20 plus 57.5-60 lump sum	417	483	9	-
Tony Cornwell	0-2.5	5-7.5	75	100	14	-
Bill Mason	0-2.5 plus 2.5-5.0 lump sum	17.5-20 plus 55-57.5 lump sum	331	430	27	-
Sam Evans	0-2.5 plus 2.5-5.0 lump sum	5-7.5 plus 15-17.5 lump sum	54	86	12	-
Hugh Evans	0-2.5 plus 0-2.5 lump sum	22.5-25 plus 67.5-70 lump sum	407	512	13	-
Chris Quine	0-2.5 plus 2.5-5.0 lump sum	15-17.5 plus 47.5-50 lump sum	181	261	20	-
Andy Moffat	0-2.5 plus 2.5-5.0 lump sum	17.5-20 plus 52.5-55 lump sum	241	329	25	-
Xanthe Christophers	0-2.5	0-2.5	3	13	8	-

CETV: Cash Equivalent Transfer Value.

Civil Service Pensions

Pension benefits are provided through the Civil Service Pension arrangements. From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (classic, premium and classic plus). The schemes are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium and classic plus are increased annually in line with changes in the Retail Prices Index. New entrants after 1 October 2002 may choose between membership of premium or joining a good quality 'money purchase' stakeholder arrangement with a significant employer contribution (partnership pension account).

Employee contributions are set at the rate of 1.5% of pensionable earnings for classic and 3.5% for premium and classic plus. Benefits in classic accrue at the rate of 1/80th of pensionable salary for each

year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike classic, there is no automatic lump sum (but members may give up (commute) some of their pension to provide a lump sum). Classic plus is essentially a variation of premium, but with benefits in respect of service before 1 October 2002 calculated broadly as for classic.

The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product chosen by the employee from a selection of approved products. The employee does not have to contribute but where they do make contributions, the employer will match these up to a limit of 3% of pensionable salary (in addition to the employer's basic contribution). Employers also contribute a further 0.8% of pensionable salary to cover the cost of centrally provided risk benefit cover (death in service and ill health retirement).

Further details about the Civil Service pension arrangements can be found at the website www.civilservice-pensions.gov.uk

Cash Equivalent Transfer Values

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The CETV figures, and from 2003–04 the other pension details, include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the Civil Service Pension arrangements and for which the CS Vote has received a transfer payment commensurate with the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries.

Please note that the factors used to calculate the CETV were revised on 1 April 2005 on the advice of the Scheme Actuary. The CETV figure for 31 March 2005 has been restated using the new factors so that it is calculated on the same basis as the CETV figure for 31 March 2006.

Real increase in CETV

This reflects the increase in CETV effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

Professor J.M. Lynch

Chief Executive and Agency Accounting Officer

13 July 2006

Statement of Forestry Commission's and Chief Executive's Responsibilities

Under Section 7 of the Government Resources and Accounts Act 2000 the Treasury has directed the Forestry Commission to prepare a statement of accounts for Forest Research for each financial year in the form and on the basis set out in the accounts direction. The accounts are prepared on an accruals basis and must give a true and fair view of the Forest Research state of affairs at the year-end and of its income and expenditure, recognised gains and losses and cash flows for the financial year.

In preparing the accounts the Forestry Commission is required to:

- observe the accounts direction, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards, as set out in the *Financial reporting manual*, have been followed, and disclose and explain any material departures in the financial statements;
- prepare the financial statements on the going concern basis, unless it is inappropriate to assume that Forest Research will continue in operation.

The Director General of the Forestry Commission, as Principal Accounting Officer, has designated the Chief Executive of Forest Research as the Accounting Officer for the Agency. His relevant responsibilities as Agency Accounting Officer, including his responsibility for the propriety and regularity of the public finances and for the keeping of proper records, and for safeguarding the Agency's assets, are set out in the Accounting Officers' Memorandum, issued by the Treasury and published in *Government accounting* (The Stationery Office).

Statement on Internal Control

1. Scope of responsibility

As Agency Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of Forest Research policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in *Government accounting*.

The Director General is the Deputy Chairman of the Forestry Commissioners and the senior official in the Forestry Commission. In addition to his role as a Commissioner, he is the Principal Accounting Officer, formally responsible to Parliament for the financial affairs of the Forestry Commission, including the Agency. In practice, the Director General's role in relation to the Agency is delegated to the Chief Executive as Agency Accounting Officer.

The Chief Executive of the Agency is responsible, normally through the Director General, to the Forestry Commissioners for the management of the Agency. The Chief Executive has a right of access to the Commissioners, and to Forestry Ministers, and will meet them at least once a year. The Director General designates the Chief Executive as Agency Accounting Officer, responsible for the Agency's accounts and financial procedures, and for the proper, effective and efficient use of resources provided to the Agency within the terms of the Framework Document and in pursuit of the agreed Corporate Plan objectives and targets. The Chief Executive is a member of the Forestry Commission's Executive Board.

In particular, the Chief Executive is responsible for:

- preparing the Agency's Corporate Plans and for achieving the targets set in them;
- appointment and organisation of the Agency's staff, and deployment of other resources to achieve the aims and objectives;
- maintaining financial and management information systems to assist in the monitoring and control of performance;
- preparing and submitting the Agency's Annual Report and Accounts;
- establishing and chairing an Agency Executive Board comprising senior managers within the Agency.

The Director General and Chief Executive are liable to be summoned to appear before the Public Accounts Committee to answer for their respective responsibilities. It will be for Ministers to decide who should represent them at other Parliamentary Committee hearings. In practice, where a Committee's interest is confined to the day-to-day operations of the Agency, Ministers will normally regard the Chief Executive as the person best placed to appear on their behalf.

2. The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the Agency's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in the Agency for the year ended 31 March 2006 and up to the date of approval of the Annual Report and Accounts, and accords with Treasury guidance.

3. Capacity to handle risk

The Agency has taken a positive approach to risk management, which it feels is entirely appropriate to its role and remit. Risk management is the responsibility of every member of staff in Forest Research. Everyone has a role to play in managing the risks within their own area of authority. Risk awareness and responsibility lies in parallel with the structure of Forest Research's objectives. At every level of objective there is an equivalent delegation of responsibility of associated risk.

The resources available for managing risk are finite and so the aim is to achieve an optimum response to risk, prioritised in accordance with the evaluation of risk. The system of internal control incorporates risk management. The system encompasses a number of elements that together facilitate an effective and efficient operation, enabling Forest Research to respond to a variety of operational, financial and commercial risks. These elements include:

- Policies set by the Board of Commissioners and the Forest Research Executive Board. Written procedures support the policies where appropriate.
- Comprehensive regular reporting to the Executive Board designed to monitor key risks and their controls. Decisions to rectify problems are made at their regular meetings.
- Planning and budgeting system used to set objectives, agree action plans and allocate resources. Progress towards meeting plan objectives is monitored regularly.

The Forestry Commission has a departmental Risk Improvement Manager who chairs a Risk Management Group comprising a risk champion from each part of the organisation and an Internal Audit representative. During the year, the Finance Director of Forest Research has acted as risk champion for the Agency, including responsibility for maintenance and enhancement of the risk register.

4. The risk and control framework

Forest Research is committed to a process of continuous development and improvement: developing systems in response to any relevant reviews and developments in best practice in this area. In particular, in the period covering the year to 31 March 2006 and up to the signing of the accounts Forest Research has:

- Attended a risk management workshop conducted by a private sector expert.
- Participated in the Commission-wide Risk Management Group (RMG), whose purpose is to ensure continued development of risk management within, and sharing of best practice across, the Commission.
- Implemented the revised Forestry Commission risk policy statement presented to the Forestry Commission Executive Board in February 2005.
- Continued to update the Agency risk register in consultation with Heads of Division in preparation for cascading specific responsibilities throughout the Agency.
- Supported the purchase and development of a commercial risk management software package.

The size and membership of the Forestry Commission Audit Committee is designed to represent all parts of the Forestry Commission. The Chief Executive of Forest Research is a member of the Committee which met three times during the year, in April, July and December 2005, to consider a range of reports from management, internal audit and external audit. As part of the governance framework, the Board of Commissioners received oral reports from the Committee Chair on business during the year and a more formal annual report on the discharge of its duties in June 2006.

The Audit Committee, in the main, deals with higher level issues concerning control and governance. The Agency Chief Executive was provided with more detailed advice on the work of Internal Audit in particular, and control in general, via the Agency's Internal Control Committee (ICC).

The ICC's objectives are:

- to provide a forum for senior management to discuss internal control and audit matters;
- to promote understanding of the internal audit role and objectives;
- to assist the Head of Internal Audit in defining the scope of audit coverage and assessing priorities.

The Committee met twice during the year, in November 2005 and March 2006, to receive reports on internal audit activity, risk management and feedback on the work of the Audit Committee.

5. Review of effectiveness

As Agency Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the Agency who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Executive Board, the Audit Committee and the ICC and a plan to address weaknesses and ensure continuous improvement of the system is in place.

The Head of Internal Audit has prepared an annual report and assurance statement to me as the Agency Accounting Officer. The report includes an overall assessment of the adequacy and effectiveness of risk management, control and governance within the Agency. The Director General as Principal Accounting Officer has received a similar report and assurance statement including any comments specific to the Great Britain core responsibilities. The overall opinion is that internal control within Forest Research continues to provide substantial assurance that material risks to the achievement of objectives are adequately managed.

A review of the structure, interactions and functioning of the Forestry Commission's corporate governance framework was undertaken during 2005-06 by Internal Audit and the Corporate and Forestry Support Division. It covered the decision-making bodies at both Great Britain level and within countries and agencies. During the review, Internal Audit referred to two best practice guides, the draft Code of Good Practice on corporate governance in government departments and the CMPS Toolkit on maximising board effectiveness. The Forestry Commission's Executive Board will now consider the recommendations before proposing changes for approval by the Board of Commissioners. A separate review will be undertaken of the structure, relationship and work of the Audit Committee and ICCs during 2006-07.

Forest Research implemented an internal reorganisation of the Agency's management structure in July 2004 with consequential appointments of new Heads of Division, a revised Research Strategy, and preparation for implementation of a formal quality assurance scheme. During 2005-06, the ongoing work included updating management responsibility for risk to fully incorporate the new Heads of Division, where appropriate and the appointment of a full-time Quality Assurance Manager to take forward the Agency's QA objectives. Under present arrangements, I rely on the organisational structure for managing risk with clear responsibilities at every level supported by a Risk Management Group whose role is to assist in the development of good risk management practice throughout the Forestry Commission. During 2006-07, the Agency will introduce a framework of Certificates of Assurance to further support my review of effectiveness of the system of internal control.

6. Significant internal control problems

None were identified during the year.

Professor J.M. Lynch

Chief Executive and Agency Accounting Officer

13 July 2006

Forest Research Agency

The Certificate and Report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statement of the Forest Research Agency for the year ended 31 March 2006 under the Government Resources and Accounts Act 2000. These comprise the Income and Expenditure Account and Statement of Total Recognised Gains and Losses, the Balance Sheet, the Cashflow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Agency, the Chief Executive and Auditor

The Agency and Chief Executive are responsible for preparing the Annual Report and the financial statements in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the Financial Statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report to you if, in my opinion, the Annual Report is not consistent with the financial statements, if the Agency has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 81–83 reflects the Agency's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Agency's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Annual Report, the unaudited part of the Remuneration Report and the Management Commentary. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with United Kingdom Auditing Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Agency and Chief Executive in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Agency's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity and that, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and [the financial transactions] conform to the authorities which govern them. In forming my opinion I have also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of the Agency's affairs as at 31 March 2006 and of the deficit, total recognised gains and losses and cashflows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn

Comptroller and Auditor General

18 July 2006

National Audit Office

157–197 Buckingham Palace Road

Victoria

London SW1W 9SP

Income and Expenditure Account for the year ended 31 March 2006

	Notes	2005-06 £000	2004-05 £000
Income			
Income from research, development and survey services			
Forestry Commission customers	2	12,348	11,489
Non-Forestry Commission Customers			
European Union		998	1,133
Other		1,015	980
Total income		14,361	13,602
Expenditure			
Staff costs	3	8,915	8,399
Other management costs	4	2,298	2,210
Materials and services	5	2,688	2,611
Total expenditure		13,901	13,220
Net operating surplus/(deficit)			
		460	382
Exceptional item – provision for restructuring costs	17	(369)	–
Notional cost of capital	8	(441)	(409)
Net (deficit) for the year		(350)	(27)
Net (deficit) transferred to General Fund		(350)	(27)

Statement of Total Recognised Gains and Losses for the year ended 31 March 2006

	2005-06 £000	2004-05 £000
Net (deficit) for the year	(350)	(27)
Revaluation surplus for the year	744	404
Total recognised gains/(losses)	394	377

The notes on pages 89 to 100 form part of these accounts.

Balance Sheet as at 31 March 2006

	Notes	2005-06 £000	2004-05 £000
Fixed assets			
Tangible assets	6	11,607	11,114
Intangible assets	7	107	50
		11,714	11,164
Current assets			
Stocks and Work in Progress	9	1,286	462
Debtors	10	750	1,406
Cash at banks and in hand	11	227	548
		2,263	2,416
Creditors – amounts falling due within one year	12	(443)	(609)
Net current assets		1,820	1,807
Total assets less current liabilities		13,534	12,971
Provisions for liabilities and charges	13 & 17	(443)	(78)
		13,091	12,893
Taxpayers' Equity			
General Fund	14	7,345	7,852
Revaluation Reserve	15	5,746	5,041
		13,091	12,893

Professor J.M. Lynch

Chief Executive and Agency Accounting Officer

13 July 2006

The notes on pages 89 to 100 form part of these accounts.

Cash Flow Statement for the year ended 31 March 2006

	Notes	2005-06 £000	2004-05 £000
Net cash inflow/(outflow) from operating activities	16a	706	(11)
Capital expenditure	16b	(489)	(360)
Net cash surplus		217	(371)
Financing – net cash transfer (to)/from Forestry Commission		(538)	407
(Decrease)/Increase in cash in the period		(321)	36

The notes on pages 89 to 100 form part of these accounts.

Notes to the Accounts

Note 1. Accounting Policies

1.1 Form of Accounts

In accordance with Section 7 of the Government Resources and Accounts Act 2000, the accounts are drawn up in a format agreed and approved by Treasury. They are prepared in accordance with the *Government financial reporting manual* (FReM) issued by HM Treasury for 2005–06 accounts, under the historical cost convention modified by the inclusion of the valuation of assets.

The accounting policies contained in the FReM follow UK Generally Accepted Accounting Practice for companies (UK GAAP) to the extent that it is meaningful and appropriate to the public sector.

The particular accounting policies adopted by the Agency are described below. They have been applied consistently in dealing with items considered material in relation to the accounts.

1.2 Tangible Fixed Assets

Where the Agency is the principal beneficial user of assets of the Forestry Commission estate, they are treated as a fixed asset of the Agency although legal ownership is vested in the Forestry Ministers.

Staff payroll costs and expenditure on materials, consumables, etc., of systems development software, for general use within the Agency, are recognised as tangible fixed assets. There was no relevant in-house development activity in the year 2005–06.

The normal threshold for the capitalisation of assets is £1,500, but all IT equipment costing £250 or more is capitalised as a pooled asset.

1.3 Valuation of Assets

In accordance with UK GAAP, professional valuation of non-forest land and buildings shall be undertaken on a five-yearly basis with a formal review in the third year. The first five-yearly valuation shall be undertaken at 31 March 2008.

In 2004–05, professionally qualified staff employed by the Commission carried out a review into the use of the indices provided by the District Valuer. The review concluded that the use of the indices provided a reasonable restatement of the current value of non-forest land and buildings. The indices were therefore used to restate values as at 31 March 2006 and shall be used in each year until the professional valuation at 31 March 2008.

Other tangible and intangible fixed assets are revalued annually using a range of appropriate indices as provided by the Office for National Statistics.

All revaluation surpluses and deficits are taken to the Revaluation Reserve.

1.4 Depreciation

Freehold land is not depreciated.

Depreciation is provided on all other tangible assets at rates calculated to write off the valuation, less estimated residual value, of each asset evenly over its expected useful life.

Freehold buildings – 20 to 80 years.

Scientific equipment – 6.5 to 20 years.

IT hardware – 3 to 10 years.

Other machinery and equipment – 10 to 20 years.

1.5 Intangible Fixed Assets

Purchases of software with an acquisition value of £1500 are recognised as intangible fixed assets and amortised over their expected useful lives to a maximum of seven years. Software purchases with an acquisition value of less than £1500 are also treated as intangible fixed assets, on a pooled asset basis, the amount being material.

1.6 Stocks and Work in Progress

Work in progress on long-term projects is valued at the cost of staff time and other direct costs plus attributable overheads based on the normal level of activity.

1.7 Provision for Bad and Doubtful Debts

Specific provision for bad and doubtful debts is set aside on the basis of a review of individual debts at the end of the year.

1.8 Research and Development

As a provider of research services, all income and expenditure on research and development is written off to the Income and Expenditure Account.

1.9 Cost of Capital Charges

Charges, representing the cost of capital utilised by the Agency, are identified on the Income and Expenditure Account. The charge is calculated at the Government's standard rate of 3.5% in real terms on the average carrying amount of all assets, except for cash balances, less liabilities.

1.10 Corporation Tax

Forest Research is not subject to corporation tax.

1.11 Value Added Tax

The Forestry Commission is registered for Value Added Tax (VAT) and accounts for it on a Great Britain basis, including any Agency activity. Income and expenditure shown in the accounts is net of any recoverable VAT. Non-recoverable VAT is charged to the accounts in the year in which it is incurred.

1.12 Foreign Currencies

Transactions in foreign currencies are recorded at the rate ruling at the time of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the rates ruling at that date. Translation differences are recorded in the Income and Expenditure account.

1.13 Insurance

In accordance with normal Government accounting practice, the Forestry Commission carries its own insurance risks.

1.14 Pensions

Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS), which is non-contributory and unfunded. The Forestry Commission recognises the expected cost of providing pensions on a systematic and rational basis over the period during which it accrues benefits from employees' services by payment to the PCSPS of amounts calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS. Further information on pensions is contained in the Remuneration report and note 3 to the accounts.

1.15 Provisions

Forest Research provides for legal or constructive obligations which are of uncertain timing or amount at the balance sheet date on the basis of the best estimate or the expenditure required to settle the obligation. Where the effect of the time value of money is significant, the estimated risk-adjusted cash flows are discounted using the real rate set by HM Treasury (currently 2.2%).

1.16 Third Party Assets

Forest Research acts as co-ordinator for a number of projects partially funded by the European Commission. The duties of co-ordinators include receiving funds on behalf of partners for onward transmission once work programmes have been approved. These Third Party Assets, which neither the Agency or government more generally has a direct beneficial interest in, are not recognised in the accounts.

Note 2. Income from Forestry Commission and Forest Enterprise

2.1 The Agency undertakes a significant proportion of the Forestry Commission's overall annual research programme in the form of specifically commissioned projects to deliver agreed outputs. A separate annual charge is agreed for each project based on full cost recovery. These charges amounted to £10.6 million not including other *ad hoc* or unplanned projects. Costs established in one year are used to determine project charges for future years. The Agency also provides research and survey services for Forest Enterprise and other parts of the Forestry Commission on a full cost recovery basis.

Income from Forestry Commission customers consisted of:

	2005-06	2004-05
	£000	£000
Research, development and other services to:		
Forestry Commission	11,185	10,432
Forest Enterprise	1,163	1,057
	12,348	11,489

Note 3. Staff Costs and Numbers

3.1 Employee costs during the year amounted to:

	2005-06	2004-05
	£000	£000
Wages and Salaries	7,090	6,955
Social Security Costs	547	539
Employer's Superannuation Costs	1,277	904
Agency Staff Costs	1	1
	8,915	8,399

Average number of employees (full-time equivalents)

	2005-06	2004-05
	287	278

Staff were covered by the Principal Civil Service Pension Scheme (PCSPS) which is an unfunded multi-employer defined benefit pension scheme but the Forestry Commission is unable to identify its share of the underlying assets and liabilities. The scheme actuary valued the scheme as at 31 March 2003. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk).

For 2005-06, employers contributions of £1,277,000 were payable to the PCSPS (2004-05: £904,000) at one of four rates in the range 16.2% to 24.6% (2004-05: 12% to 18.5%) of pensionable pay, based on salary bands. The scheme actuary reviews employer contributions every four years following a full scheme valuation. From 2006-07 the salary bands will be revised and the rate will be in a range between 17.1% and 25.5%. The contribution rates reflect benefits accruing during 2005-06 to be paid to the member when they retire and not the benefits paid during this period to existing pensioners.

Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. No Agency staff have yet taken this option.

3.2 Benefits in kind are provided under the following schemes:

- (i) Advances of Salary for House Purchase
- (ii) Advances of Salary for purchase of Season Tickets and Bicycles
- (iii) Car Provision for Employees Scheme.

Each scheme is subject to conditions and financial limits.

The Advances of Salary for House Purchase scheme had loans with an outstanding balance of £2,500 or more to seven individual members of staff at 31 March 2006. The total outstanding value of all loans was £51,718.24.

Note 4. Other Management Costs

	2005-06	2004-05
	£000	£000
Auditors' remuneration	22	22
Travel and subsistence	533	468
Staff transfer expenses	71	15
Training	153	131
Building maintenance	394	411
Utilities	325	251
Computer supplies	92	85
Early retirement/departure costs	25	135
Employer liability provisions and payments	-	55
Depreciation of fixed assets	571	518
Loss on disposal of fixed assets	11	-
Other expenditure	101	119
	2,298	2,210

Included within Other Management Costs are charges from the Forestry Commission and Forest Enterprise amounting in total to £118,000 (2004-05: £116,000).

Note 5. Materials and Services

	2005-06	2004-05
	£000	£000
Materials and supplies	784	800
Central services from Forestry Commission	697	722
Vehicle lease charges from Forestry Commission	418	401
Contractors	368	335
Commissioned research	182	147
Publications	29	44
Protective clothing	25	20
Miscellaneous expenditure	185	142
	2,688	2,611

Included within Materials and Services are charges from the Forestry Commission and Forest Enterprise amounting in total to £1,115,000 (2004-05: £1,123,000).

Charges are made to Forest Research from the Forestry Commission and Forest Enterprise, as appropriate, for assistance with field experiments, hire of vehicles, machinery and equipment and for personnel, business management, financial and other support services at Silvan House, Edinburgh.

Note 6. Tangible Fixed Assets

	Freehold Land and Buildings	Scientific Equipment	IT Equipment	Other Machinery and Equipment	Total
	£000	£000	£000	£000	£000
Valuation:					
At 1 April 2005	10,096	2,094	798	1,206	14,194
Additions	70	139	148	52	409
Disposals	–	(476)	(83)	(625)	(1,184)
Transfers (note 14)	(117)	–	–	13	(104)
Revaluation	814	4	(35)	3	786
At 31 March 2006	10,863	1,761	828	649	14,101
Depreciation:					
At 1 April 2005	562	1,304	417	797	3,080
Provided in year	215	123	184	30	552
Disposals	–	(475)	(83)	(615)	(1,173)
Transfers (note 14)	(8)	–	–	9	(1)
Revaluation	43	2	(14)	3	34
At 31 March 2006	812	954	504	224	2,494
Net book value:					
At 31 March 2006	10,051	807	324	425	11,607
At 31 March 2005	9,534	790	381	409	11,114

Fixed assets were revalued as at 31 March 2006 in accordance with accounting policies. The valuation includes the principal research stations at Alice Holt Lodge near Farnham in Surrey and the Northern Research Station, Roslin near Edinburgh, with net book values of £6.9 million and £3.0 million respectively at 31 March 2006.

Note 7. Intangible Fixed Assets

	2005–06	2004–05
	£000	£000
Valuation		
Balance at 1 April	59	36
Additions	84	23
Revaluation	(8)	–
As at 31 March	135	59
Amortisation		
Opening balance	9	–
Depreciation in year	19	9
Revaluation	–	–
As at 31 March	28	9
Net book value	107	50

Intangible fixed assets relate wholly to purchased software.

Note 8. Cost of Capital

Notional cost of capital based on 3.5% of average total assets, excluding bank balances, less current liabilities employed in 2005–06 amounted to £441,147 (2004–05: £409,421).

Note 9. Stocks and Work in Progress

	2005–06	2004–05
	£000	£000
Research Work in Progress	1,286	462
	1,286	462

Note 10. Debtors

	2005-06	2004-05
	£000	£000
Amounts falling due within one year		
EU debtors	297	906
Other Trade debtors	228	251
Other debtors	23	26
Prepayments	170	201
	718	1,384
Amounts falling due after one year		
House purchase loans	32	22
	750	1,406

Note 11. Cash at banks and in hand

The following balances at 31 March are held at commercial banks and cash in hand

	2005-06	2004-05
	£000	£000
Opening balance at 1 April	548	512
Net change in balances	(321)	36
Balance at 31 March	227	548

As part of its normal activities Forest Research maintains Sterling and Euro bank accounts primarily used for the receipt of income from non-Forestry Commission customers. These accounts are cleared to the Commission's main account on a regular basis. Sums held in these accounts on behalf of partners in European Commission projects are treated as third party assets and not included in the balances shown (see note 1.16).

Note 12. Creditors: amounts falling due within one year

	2005-06	2004-05
	£000	£000
Payments received on account	50	297
Trade creditors	382	311
Other creditors including taxation and social security costs	11	1
	443	609

Funds held on behalf of partners in European Commission projects are treated as third party assets and not recorded on the face of the accounts (see note 1.16). At 31 March 2006 the amount held in Forest Research Bank accounts on behalf of partners was £26,500.81, which was subsequently paid over (31 March 2005: £345,791.36).

Note 13. Provisions for Liabilities

	2005-06	2004-05
	£000	£000
Employer liability claims		
Balance brought forward	–	150
Utilised in year	–	(150)
Provided in year	–	–
Balance carried forward	–	–
Early departure costs		
Balance brought forward	78	–
Provided in year	379	94
Utilised in year	(19)	(5)
Unwinding of discount	5	(11)
Balance carried forward	443	78

Note 14. General Fund

	2005-06	2004-05
	£000	£000
Balance brought forward	7,852	6,926
Transfer from revaluation reserve – disposed assets	–	–
Movement in year		
Retained surplus	39	–
Net (deficit) for year	(350)	(27)
Transfer of fixed assets to(-)/from other Forestry Bodies	(106)	113
Cash surplus to(-)/deficit from Forestry Commission	(538)	407
Non-cash inter-country transfers	7	24
Notional cost of capital	441	409
Balance carried forward	7,345	7,852

Transfers of fixed assets from other parts of the Forestry Commission were buildings at Cairnbaan.

Note 15. Revaluation Reserve

	2005–06	2004–05
	£000	£000
Balance brought forward	5,041	4,637
Retained surplus	(39)	–
Revaluation surplus/(deficit) for the year ended 31 March 2006		
Land and Buildings	771	395
IT, Scientific and other machinery and equipment	(19)	9
Intangible assets	(8)	–
Balance carried forward	5,746	5,041

Note 16. Note to the Cash Flow Statement

16a. Reconciliation of operating cost to operating cash flows

	2005–06	2004–05
	£000	£000
Net (deficit) for the year	(350)	(27)
Notional cost of capital	441	409
Depreciation	571	518
Loss/(profit) on disposal of assets	11	–
(Increase)/Decrease in stocks and work in progress	(825)	74
Decrease/(Increase) in debtors	655	(793)
(Decrease)/Increase in creditors	(169)	(144)
Increase/(Decrease) in provisions	365	(72)
Non-cash inter-country transfers	7	24
Net cash inflow/(outflow) from operations	706	(11)

16b. Analysis of capital expenditure

	2005–06	2004–05
	£000	£000
Tangible fixed assets	405	337
Intangible fixed assets	84	23
Total cash expenditure on fixed assets	489	360

Note 17. Exceptional Items: provision for early retirement/redundancy costs

A provision has been made at 31 March 2006 in respect of plans to restructure the Agency's Technical Support Unit, which will involve a number of early retirements and redundancies. Implementation will begin during 2006–07. This provision has been recognised as an exceptional item in the Income and Expenditure Account and as a liability in the Balance Sheet. In year expenditure, together with ongoing commitments to staff taking early retirement, is expected to cost £369,000 at current (2005–06) prices. This will be funded from the Agency's own resources. In subsequent years net savings of more than £200,000 a year will be achieved.

Note 18. Related Party Transactions

During the year, Forest Research has had a significant number of material transactions with the Forestry Commission and Forest Enterprise country agencies who are regarded as related parties.

In addition, Forest Research has had various material transactions with other Government Departments and other central Government bodies. Most of these transactions have been with the Department of Trade and Industry and the Department for Environment, Food and Rural Affairs.

Professor Jim Lynch, Chief Executive, is Distinguished Professor of Life Sciences at the University of Surrey. The value of payments to the University for services provided in the year to 31 March 2006 was £48,260. Sam Evans and Peter Freer-Smith hold visiting professorships at the Universities of Sheffield and Southampton respectively, with which £11,855 and £7,000 was spent on research services. Other members of staff hold professorships at UK and foreign universities but no financial transactions took place with these in 2005-06.

Note 19. Losses Statement

Losses totalled £4,000 from 1 case (2004–05: £4,230 from 1 case). Special payments totalled £11,591.45 from 14 cases (2004–05: £12,268 from 14 cases).

Note 20. Financial Instruments

FRS 13: *Derivatives and other financial instruments* requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Because of the way in which government departments are financed, the Agency is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which FRS 13 mainly applies. The Agency has no powers to borrow or invest surplus funds and financial assets and liabilities are generated by day-to-day operational activities and are held not to change the risks facing the Agency in undertaking its activities.

Liquidity risk

The Agency is not exposed to significant liquidity risks because its net revenue and capital resource requirements are financed by resources voted annually by the UK Parliament.

Interest rate risk

The Agency is not exposed to interest rate risk.

Foreign currency risk

The Agency has commercial relations with foreign customers and the European Commission, having dealings in foreign currencies and the Euro as well as Sterling. The treatment of gains and losses arising from transactions in foreign currencies is described at note 1.12 to the accounts. The Agency is therefore exposed to foreign currency risk, but the risk is not significant with income from these sources being no more than 9% of the Agency's total income.

Note 21. Financial Performance Measures

The Agency's net deficit after making provision for the early retirement and redundancy costs of restructuring was £350,000. Financial performance from normal operating activity achieved an operating surplus of £460,000, which, after allowing for the cost of capital, and before exceptional items, represented a cost recovery of 100.1% (2004–05: 99.8%).

Printed in the UK for The Stationery Office Limited on behalf of the Controller
of Her Majesty's Stationery Office

07/06