

Accounts

for the year ended 31 March 2007

Year ended 31 March 2007

Balance Sheet as at 31 March 2007

| | Notes | 2006-07 £000 | 2005-06 £000 |
|--|-------|-----------------|-----------------|
| Fixed assets | | | |
| Tangible assets | 6 | 12,802 | 11,607 |
| Intangible assets | 7 | 183 | 107 |
| | | 12,971 | 11,714 |
| Creditors falling due after more than one year | 10 | 51 | |
| Current assets | | | |
| Stocks and Work in Progress | | | |
| Debtors | | | |
| Cash at banks and in hand | | | |

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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 is being 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 9 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; and work on forest condition monitoring, funded by the EC through the Forest Focus programme, drew towards completion.

The year saw the Agency's continuing 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, continue to progress apace. These are confidently expected to bear fruit in future years.

The successful bid for PSRE funding in 2005–06, which yielded £495,000 over a three-year period, is enabling 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 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. Accordingly restructuring plans were prepared, involving a number of early retirements and redundancies, and these were implemented during 2006–07. The costs were met from the Agency's own resources.

7. Financial review

This is Forest Research's tenth year of operation as an Agency. Forest Research produced a net operating surplus of £454,000 on its Income and Expenditure Account, excluding the notional cost of capital. A comparison of income and expenditure with the previous year's results shows that:

- staff costs increased by £602,000 (6.8%)
- other management costs by £206,000 (9.0%)
- materials and services costs increased by £391,000 (14.5%)
- income from Forestry Commission customers increased by £817,000 (6.6%)
- income from external customers increased by £376,000 (18.9%)
- the notional cost of capital increased by £34,000 (7.7%).

The net deficit for the year after the cost of capital charge of £475,000 and depreciation was £21,000, representing a cost recovery rate of 99.9%.

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 £357,000, which was handed over to the Forestry Commission.

Additions to fixed assets in the year were £580,000.

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 2006–07 the recovery rate was 99.9%.

Performance against other operational, scientific and financial KPIs is reported in the main body of the Annual Report and Accounts. The KPI to achieve £2.1m from income from non-FC customers was exceeded by £0.3m. 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. Compared with 2005–06, efficiency savings have been achieved against both of these KPIs with the overall cost measure reducing by 3% and support services reducing by 8%. These calculations are derived from a detailed analysis of staff time records which cover 100% of the time of all Agency staff.

9. Events since the balance sheet date

There were no material events since the balance sheet.

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) in England, Scotland and Wales take the lead in establishing and maintaining channels of communication with stakeholders and in developing new initiatives for improving knowledge transfer.

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 2006–07 indicates that 100% 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 (until 5 May 2006)</i> |
| Rt. Hon. David Miliband MP | <i>Secretary of State, Department for Environment, Food and Rural Affairs (from 5 May 2006)</i> |
| Jim Knight MP | <i>Parliamentary Under-Secretary (Commons), Department for Environment, Food and Rural Affairs (until 5 May 2006)</i> |
| Barry Gardiner MP | <i>Parliamentary Under-Secretary (Commons), Department for Environment, Food and Rural Affairs (from 5 May 2006)</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 Director</i> |
| Bill Mason | <i>Head of Forest Management Division</i> |
| Sam Evans | <i>Head of Biometrics, Surveys and Statistics Division</i> |
| Hugh Evans | <i>Head of Tree Health Division</i> |
| Chris Quine | <i>Head of Ecology Division</i> |
| Andy Moffat | <i>Head of Environmental and Human Sciences 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 (page 86).

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 £23,000. 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

11 July 2007

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 Management 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.

| | 2006-07 | | 2005-06 | |
|---------------------|----------------|--|----------------|--|
| | 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 | 70-75 | 3,600 | 65-70 | 2,000 |
| Ken Charles | 45-50 | - | 45-50 | - |
| Tony Cornwell | 45-50 | - | 45-50 | - |
| Bill Mason | 55-60 | - | 50-55 | - |
| Sam Evans | 45-50 | - | 45-50 | - |
| Hugh Evans | 55-60 | 1,500 | 55-60 | 1,300 |
| Chris Quine | 55-60 | - | 50-55 | - |
| Andy Moffat | 55-60 | - | 55-60 | - |
| Xanthe Christophers | 45-50 | - | 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 HM Revenue and Customs 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 at 31/3/07 and related lump sum | CETV @ 31/3/06 | CETV @ 31/3/07 | Real increase in CETV after adjustment for inflation and changes in market investment factors | Employer contribution to partnership pension account including risk benefit cover |
|------------------------|--|--|-----------------------|-----------------------|--|--|
| 2006-07 | £000 | £000 | £000 | £000 | £000 | nearest £100 |
| Jim Lynch | 0-2.5 | 2.5-5 | 76 | 76 | 25 | - |
| Peter Freer-Smith | 0-2.5 plus 2.5-5.0 lump sum | 17.5-20 plus 57.5-60 lump sum | 340 | 362 | 14 | - |
| Ken Charles | 0-2.5 plus 0-2.5 lump sum | 20-22.5 62.5-65 lump sum | 483 | 485 | 7 | - |
| Tony Cornwell | 0-2.5 | 5-7.5 | 100 | 112 | 12 | - |
| Bill Mason | 0-2.5 plus 0-2.5 lump sum | 20-22.5 plus 60-62.5 lump sum | 430 | 467 | 17 | - |
| Sam Evans | 0-2.5 plus 0-2.5 lump sum | 5-7.5 plus 17.5-20 lump sum | 86 | 97 | 9 | - |
| Hugh Evans | 0-2.5 plus 2.5-5 lump sum | 22.5-25 plus 72.5-75 lump sum | 512 | 554 | 23 | - |
| Chris Quine | 0-2.5 plus 2.5-5.0 lump sum | 15-17.5 plus 50-52.5 lump sum | 261 | 279 | 13 | - |
| Andy Moffat | 0-2.5 plus 2.5-5.0 lump sum | 17.5-20 plus 57.5-60 lump sum | 329 | 356 | 16 | - |
| Xanthe Christophers | 0-2.5 | 0-2.5 | 13 | 23 | 8 | - |

CETV: Cash Equivalent Transfer Value.

Civil Service Pensions

Pension benefits are provided through the Principal Civil Service Pension Scheme. 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 Principal Civil Service Pension Scheme 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 Principal Civil Service Pension Scheme 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.

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

11 July 2007

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 comply with the requirements of the *Government financial reporting manual* and in particular 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 *Government 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 2007 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 2007 and up to the signing of the accounts Forest Research has:

- Organised risk management workshops 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.
- Updated existing risk registers to reflect newly identified potential risks and appropriate control measures for agreement by management board members. This has included the further enhancement of the Risk Register methodology to clearly define inherent and residual risk.
- Continued to use and adapt the risk management software package working towards greater integration with Internal Audit and their planning.

An Internal Audit review in 2004–05 identified that the Forestry Commission needed fully developed contingency plans. The RMG has now identified a prioritised list of plans with a view to starting work on these in 2007–08. This will require investment of an internal and external resource in order to ensure completion during the next financial year.

During 2006–07 the Board of Commissioners reviewed the Forestry Commission’s Audit Committee arrangements and recommended the setting up of separate Audit and Risk Committees (ARCs) in each of the three countries and in Forest Research. Interim arrangements were put in place for Forest Research using members of the existing Internal Control Committee (ICC) and representatives from Internal and External Audit, pending the resolution of membership and terms of reference. The interim Committees met in June 2006 and March 2007. Both meetings considered a range of reports from management and from internal and external audit. At the March 2007 meeting the membership of the ARC was agreed.

The new ARC membership will consist of two Non-Executives supported by the Agency Chief Executive and the Finance Director, the Head of Internal Audit and a National Audit Office representative.

The ARC will advise the Agency Accounting Officer on:

- the strategic processes for risk, control and governance in the Agency;
- the Statement on Internal Control in the Agency;
- the accounting policies, the accounts and the annual report of the Agency, including the process for review of the accounts prior to submission for audit, levels of error identified, and management’s letter(s) of representation to the external auditors;
- the planned activity and results of both internal and external audit;
- adequacy of management response to issues identified by audit activity, including internal audit reports and external audit’s management letter;
- assurances relating to the corporate governance requirements for the Agency;
- anti-fraud policies and whistle-blowing processes.

The ARC will also periodically review its own effectiveness.

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 FR Executive Board and the Audit and Risk Committee. 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.

In September 2006 the Agency received the approval of the Forestry Commissioners for the implementation of a new Development Strategy. This concentrates on the achievement of sustainable growth and evolution in areas of high demand whilst continuing to deliver sound evidence-based research in support of FC policies.

A key element of the new strategy is the objective to deliver a 100% increase in non-Forestry Commission income by 2011–12 as a result of which this external income will increase from 15% to 27% of total income.

Work on delivering this strategy continued apace during the year with the formation of groups to review opportunities in key research areas and the launch of a review of management information systems aimed at identifying the needs associated with the radical implications of the new strategy.

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.

6. Significant internal control problems

None were identified during the year.

Professor J.M. Lynch

Chief Executive and Agency Accounting Officer

11 July 2007

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 2007 under the Government Resources and Accounts Act 2000. These comprise the Operating Cost Statement and Statement of 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. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Agency, the Chief Executive and Auditor

The Agency and Chief Executive, as Agency Accounting Officer, are responsible for preparing the Annual Report, which includes the Remuneration 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 and the part of the Remuneration Report to be audited 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 report to you whether, in my opinion, certain information given in the Annual Report, which comprises a management commentary and a review of current and future development and performance, is consistent with the financial statements. 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.

In addition, I report to you 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 HM Treasury regarding remuneration and other transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Agency's compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers 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. 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 International 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 and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error 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 and the part of the Remuneration Report to be audited.

Opinions

Audit 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 2007, and of the net operating cost, 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
- the information given within the Annual Report, which comprises management commentary and a review of current and future development and performance, is consistent with the financial statements.

Audit Opinion on Regularity

In my opinion, 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

July 2007

National Audit Office

157–197 Buckingham Palace Road

Victoria

London SW1W 9SP

Operating Cost Statement for the year ended 31 March 2007

| | Notes | 2006-07 £000 | 2005-06 £000 |
|---|-------|-----------------|-----------------|
| Income | | | |
| Income from research, development and survey services | | | |
| Forestry Commission customers | 2 | 13,165 | 12,348 |
| Non-Forestry Commission Customers | | | |
| European Union | | 995 | 998 |
| Other | | 1,394 | 1,015 |
| Total income | | 15,554 | 14,361 |
| Expenditure | | | |
| Staff costs | 3 | 9,517 | 8,915 |
| Other management costs | 4 | 2,504 | 2,298 |
| Materials and services | 5 | 3,079 | 2,688 |
| Total expenditure | | 15,100 | 13,901 |
| Net operating surplus/(deficit) | | 454 | 460 |
| Exceptional item – provision for restructuring costs | | – | (369) |
| Notional cost of capital | 8 | 475 | (441) |
| Net (deficit) for the year | | (21) | (350) |
| Net (deficit) transferred to General Fund | | (21) | (350) |

Statement of Total Recognised Gains and Losses for the year ended 31 March 2007

| | 2006-07 £000 | 2005-06 £000 |
|--|-----------------|-----------------|
| Net (deficit) for the year | (21) | (350) |
| Revaluation surplus for the year | 1,333 | 744 |
| Total recognised gains/(losses) | 1,312 | 394 |

The notes on pages 100 to 112 form part of these accounts.

Balance Sheet as at 31 March 2007

| | Notes | 31 March 2007 £000 | 31 March 2006 £000 |
|--|-------|--------------------------|--------------------------|
| Fixed assets | | | |
| Tangible assets | 6 | 12,802 | 11,607 |
| Intangible assets | 7 | 183 | 107 |
| | | 12,985 | 11,714 |
| Debtors falling due after more than one year | 10 | 51 | 32 |
| Current assets | | | |
| Stocks and Work in Progress | 9 | 1,394 | 1,286 |
| Debtors | 10 | 658 | 718 |
| Cash at banks and in hand | 11 | 248 | 227 |
| | | 2,300 | 2,231 |
| Creditors – amounts falling due within one year | 12 | (660) | (443) |
| Net current assets | | 1,640 | 1,820 |
| Total assets less current liabilities | | 14,676 | 13,534 |
| Provisions for liabilities and charges | 13 | (170) | (443) |
| | | 14,506 | 13,091 |
| Taxpayers' Equity | | | |
| General Fund | 14 | 7,495 | 7,345 |
| Revaluation Reserve | 15 | 7,011 | 5,746 |
| | | 14,506 | 13,091 |

Professor J.M. Lynch

Chief Executive and Agency Accounting Officer

11 July 2007

The notes on pages 100 to 112 form part of these accounts.

Cash Flow Statement for the year ended 31 March 2007

| | Notes | 2006-07 £000 | 2005-06 £000 |
|---|-------|-----------------|-----------------|
| Net cash inflow/(outflow) from operating activities | 16 | 958 | 706 |
| Capital expenditure (additions to fixed assets) | 16b | (580) | (489) |
| Net cash surplus | | 378 | 217 |
| Financing - net cash transfer (to)/from Forestry Commission | | (357) | (538) |
| (Decrease)/ Increase in cash in the period | | 21 | (321) |

The notes on pages 100 to 112 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 2006–07.

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 2007 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.

Any surplus on revaluation is credited to the Revaluation Reserve. A deficit on revaluation is debited to the Operating Cost Statement if the deficit exceeds the balance on the Revaluation Reserve.

1.4 Depreciation

In accordance with Forestry Commission policy, 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 £1,500 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. The amount held at 31 March 2007 was £381,488, which was paid over to partners on 19 April 2007.

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. 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:

| | 2006-07 | 2005-06 |
|--|----------------|---------|
| | £000 | £000 |
| Research, development and other services to: | | |
| Forestry Commission | 11,778 | 11,185 |
| Forest Enterprise | 1,387 | 1,163 |
| | 13,165 | 12,348 |

Note 3. Staff Costs and Numbers

3.1 Employee costs during the year amounted to:

| | 2006-07 | | | 2005-06 |
|---------------------------------|------------------------|--------------------|--------------|---------|
| | Permanent staff | Other staff | Total | |
| | £000 | £000 | £000 | £000 |
| Wages and Salaries | 6,893 | 622 | 7,515 | 7,090 |
| Social Security Costs | 540 | 45 | 585 | 547 |
| Employer's Superannuation Costs | 1,292 | 98 | 1,390 | 1,277 |
| Agency Staff Costs | – | 27 | 27 | 1 |
| | 8,725 | 792 | 9,517 | 8,915 |

| | 2006-07 | 2005-06 |
|---|----------------|---------|
| Average number of employees (full time equivalents) | | |
| Permanent staff | 251 | 253 |
| Others | 39 | 34 |
| Total staff | 290 | 287 |

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 2006-07, employers contributions of £1,389,458 were payable to the PCSPS (2005-06: £1,277,000) at one of four rates in the range 17.1% to 25.5% (2005-06: 16.2% to 24.6%) of pensionable pay, based on salary bands. The scheme actuary reviews employer contributions every four years following a full scheme valuation. The contribution rates reflect benefits accruing during 2006-07 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 three individual members of staff at 31 March 2007. The total outstanding value of all loans was £58,386.

Note 4. Other Management Costs

Other management costs are stated after charging:

| | 2006-07 | 2005-06 |
|--|----------------|---------|
| | £000 | £000 |
| Auditors' remuneration | 23 | 22 |
| Travel and subsistence | 586 | 533 |
| Staff transfer expenses | 62 | 71 |
| Training | 159 | 153 |
| Building maintenance | 430 | 394 |
| Utilities | 324 | 325 |
| Computer supplies | 92 | 92 |
| Early retirement/departure costs | 4 | 25 |
| Employer liability provisions and payments | - | - |
| Depreciation of fixed assets | 628 | 571 |
| Loss on disposal of fixed assets | - | 11 |
| Other expenditure | 196 | 101 |
| | 2,504 | 2,298 |

Included within other management costs are charges from the Forestry Commission and Forest Enterprise amounting in total to £114,000 (2005-06: £118,000).

Note 5. Materials and Services

Materials and services are stated after charging:

| | 2006–07 | 2005–06 |
|--|----------------|---------|
| | £000 | £000 |
| Materials and supplies | 742 | 784 |
| Central services from Forestry Commission | 722 | 697 |
| Vehicle lease charges from Forestry Commission | 421 | 418 |
| Contractors | 636 | 368 |
| Commissioned research | 166 | 182 |
| Publications | 63 | 29 |
| Protective clothing | 23 | 25 |
| Miscellaneous expenditure | 306 | 185 |
| | 3,079 | 2,688 |

Included within materials and services are charges from the Forestry Commission and Forest Enterprise amounting in total to £1,143,000 (2005–06: £1,115,000).

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 2006 | 10,863 | 1,761 | 828 | 649 | 14,101 |
| Additions | 22 | 122 | 110 | 219 | 473 |
| Disposals | – | – | (3) | (18) | (21) |
| Transfers (note 14) | (16) | 128 | 49 | (177) | (16) |
| Revaluation to current prices | 1,445 | (8) | (39) | 24 | 1,422 |
| At 31 March 2007 | 12,314 | 2,003 | 945 | 697 | 15,959 |
| Depreciation: At 1 April 2006 | | | | | |
| | 812 | 954 | 504 | 224 | 2,494 |
| Provided in year | 244 | 155 | 135 | 54 | 588 |
| Disposals | – | – | (3) | (17) | (20) |
| Transfers (note 14) | (3) | (11) | (2) | 13 | (3) |
| Revaluation to current prices | 111 | (4) | (15) | 6 | 98 |
| At 31 March 2007 | 1,164 | 1,094 | 619 | 280 | 3,157 |
| Net book value: | | | | | |
| At 31 March 2007 | 11,150 | 909 | 326 | 417 | 12,802 |
| At 31 March 2006 | 10,051 | 807 | 324 | 425 | 11,607 |

Fixed assets were revalued as at 31 March 2007 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 £7.6 million and £3.1 million respectively at 31 March 2007.

Note 7. Intangible Fixed Assets

| | 2006-07 | 2005-06 |
|-----------------------|------------|---------|
| | £000 | £000 |
| Valuation | | |
| Balance at 1 April | 135 | 59 |
| Additions | 107 | 84 |
| Revaluation | 10 | (8) |
| As at 31 March | 252 | 135 |
| Amortisation | | |
| Opening balance | 28 | 9 |
| Depreciation in year | 40 | 19 |
| Revaluation | 1 | |
| As at 31 March | 69 | 28 |
| Net book value | 183 | 107 |

Intangible fixed assets relates 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 2006-07 amounted to £474,627 (2005-06: £441,147).

Note 9. Stocks and Work in Progress

| | 2006-07 | 2005-06 |
|---------------------------|--------------|---------|
| | £000 | £000 |
| Research work in progress | 1,394 | 1,286 |
| | 1,394 | 1,286 |

Note 10. Debtors

10a. Analysis by type

| | 2006-07 | 2005-06 |
|--|----------------|---------|
| | £000 | £000 |
| Amounts falling due within one year | | |
| EU debtors | 242 | 297 |
| Other Trade debtors | 231 | 228 |
| Other debtors | 31 | 23 |
| Prepayments | 154 | 170 |
| | 658 | 718 |
| Amounts falling due after one year | | |
| House purchase loans | 51 | 32 |
| | 709 | 750 |

10b. Intra-Government Balances

| | 2006-07 | 2005-06 |
|---|----------------|---------|
| | £000 | £000 |
| Balances with other central government bodies | 267 | 108 |
| Balances with local authorities | - | 14 |
| Intra-Government balances | 267 | 122 |
| Balances with bodies external to government | | |
| Falling due within one year | 391 | 596 |
| Falling due after more than one year | 51 | 32 |
| | 709 | 750 |

Note 11. Cash at bank and in hand

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

| | 2006-07 | 2005-06 |
|-----------------------------------|------------|---------|
| | £000 | £000 |
| Opening balance at 1 April | 227 | 548 |
| Net change in balances | 21 | (321) |
| Balance at 31 March | 248 | 227 |

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.

Note 12. Creditors: amounts falling due within one year

| | 2006-07 | 2005-06 |
|--|------------|---------|
| | £000 | £000 |
| Payments received on account | 156 | 50 |
| Trade creditors | 492 | 382 |
| Other creditors including taxation and social security costs | 12 | 11 |
| | 660 | 443 |

All creditors are bodies external to central or local government. 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 2007 the amount held in Forest Research Bank accounts on behalf of partners was £259,144 which was subsequently paid over (31 March 2006: £26,500.81).

Note 13. Provisions for Liabilities

| | 2006-07 | 2005-06 |
|-------------------------------------|--------------|---------|
| | £000 | £000 |
| Early departure costs | | |
| Balance brought forward | 443 | 78 |
| Provided in year | 146 | 379 |
| Provision not required written back | (369) | |
| Utilised in year | (43) | (19) |
| Unwinding of discount | (7) | 5 |
| Balance carried forward | 170 | 443 |

Note 14. General Fund

| | 2006–07 | 2005–06 |
|--|----------------|---------|
| | £000 | £000 |
| Balance brought forward | 7,345 | 7,852 |
| Movement in year | | |
| Retained surplus | 68 | 39 |
| Net (deficit) for year | (21) | (350) |
| Transfer of fixed assets to (-)/from other Forestry Bodies | (13) | (106) |
| Cash surplus to (-)/ deficit from Forestry Commission | (357) | (538) |
| Non-cash inter-country transfers | (2) | 7 |
| Notional cost of capital | 474 | 441 |
| Balance carried forward | 7,495 | 7,345 |

Note 15. Revaluation Reserve

| | 2006–07 | 2005–06 |
|--|----------------|---------|
| | £000 | £000 |
| Balance brought forward | 5,746 | 5,041 |
| Revaluation surplus/(deficit) for the year ended 31 March 2007 | | |
| Land and Buildings | 1,335 | 771 |
| Scientific equipment | (4) | 2 |
| IT | (24) | (21) |
| Other machinery and equipment | 17 | – |
| Intangible assets | 9 | (8) |
| | 1,333 | 744 |
| Transfer to general fund for backlog depreciation | (68) | (39) |
| Balance carried forward | 7,011 | 5,746 |

Note 16. Note to the Cash Flow Statement

16a. Reconciliation of net deficit to net cash flow from operating activities

| | 2006-07 | 2005-06 |
|--|---------|---------|
| | £000 | £000 |
| Net (deficit) for the year | (21) | (350) |
| Adjustments for non-cash transactions | | |
| Depreciation – tangible fixed assets | 588 | 552 |
| Depreciation – intangible fixed assets | 40 | 19 |
| Non-cash inter-country transfers | (2) | 7 |
| (Profit) / loss on disposal of assets | – | 11 |
| Notional cost of capital | 475 | 441 |
| Provisions | | |
| Provided in year | 146 | 379 |
| Provisions not required written back | (369) | – |
| Unwinding of discount | (7) | 5 |
| | 850 | 1,064 |
| Adjustments for working capital | | |
| Decrease / (Increase) in stocks and work in progress | (107) | (825) |
| Decrease / (Increase) in debtors | 41 | 655 |
| Increase / (Decrease) in creditors | 217 | (169) |
| | 151 | (339) |
| Use of provisions | (43) | (19) |
| Net cash inflow/(outflow) from operations | 958 | 706 |

16b. Analysis of capital expenditure

| | 2006-07 | 2005-06 |
|---|---------|---------|
| | £000 | £000 |
| Tangible fixed assets | 477 | 405 |
| Intangible fixed assets | 107 | 84 |
| Total cash expenditure on fixed assets | 584 | 489 |

Note 17. Post Balance Sheet Events

These financial statements were authorised for issue on 10 July 2007 by the Agency Accounting Officer.

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 2007 was £61,036. Sam Evans, Head of Biometrics Division, holds a visiting professorship at the University of Sheffield with which £18,744 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 2006–07.

Note 19. Losses Statement

There were no losses (2005–06: £4,000 from 1 case).

Note 20. Contingent Liabilities

There was a contingent liability at 31 March 2007 in respect of a personal injury action by an ex-employee.

Note 21. Financial Instruments

FRS 13: Derivatives and other financial instruments require 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 22. Financial Performance Measures

The Agency's net deficit was £21,000. Financial performance from normal operating activity achieved an operating surplus of £454,000, which, after allowing for the cost of capital, and before exceptional items, represented a cost recovery of 99.9% (2005–06: 100.1%).

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