

Fisheries Research Services

Report on the 2006-07 Audit

19 December 2007

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Executive Summary

Introduction

We have audited the financial statements of Fisheries Research Services (FRS) for 2006-07 and examined aspects of performance and governance arrangements. This report sets out our key findings.

Financial Statements

We have given an unqualified opinion on both the financial statements for 2006-07 and on the regularity of transactions undertaken during the financial year.

The Operating Cost Statement records gross expenditure of £25.4 million for the year ending 31 March 2007, an increase of £2.6 million (11%) from the previous year. Net expenditure was £23 million against a budget of £22.864 million representing a small overspend of £136k (0.6%).

The accounts include a provision approaching £1 million in relation to amounts receivable in respect of work undertaken by FRS for the European Union, as an agent of the Department for Environment, Food and Rural Affairs (DeFRA). This provision reflects FRS's judgement that DeFRA will be unable to meet EU compliance requirements in order to release payments to fund the work undertaken. FRS has raised this matter with both the Scottish Government and DeFRA.

During the year FRS incurred capital expenditure of £3.1 million against its capital budget of £5.4 million, representing an underspend of £2.3 million (43%) due largely to delays in the build schedule of the new *Alba Na Mara* vessel due to variations to contract (which accounted for £1.8 million of total capital expenditure incurred during the financial year) and in acquiring the land to develop the FRS estate.

A significant number of presentation amendments were required to be made to the draft financial statements presented to Audit. We have recommended that FRS review its arrangements for preparing its annual financial statements, in particular that the draft financial statements should be subject to supervisory review before submission for audit.

Governance

We found that, in general, governance arrangements operated adequately. However, we identified some areas where further work is required to meet the requirements of the Scottish Public Finance Manual (SPFM) and other aspects of good practice in corporate governance. In particular, we recommend that membership of the Agency's audit committee be limited to non executives where possible and arrangements for identifying financial and external risks be reviewed.

FRS has identified significant control weaknesses in the system of internal controls over fixed asset management. In particular, there is no reconciliation performed between the fixed asset register and the general ledger and there is no formal fixed asset verification programme.

In addition, FRS identified fixed assets having a gross cost of £5.72 million and a net book value of £160k which were recorded in the fixed asset register but had either been disposed of in a prior period, could not be located or were surplus to operational requirements. We are satisfied that there is no material impact on the accounts in relation to this matter, however, it does represent a significant historic governance issue.

The internal audit contract with Scott Moncrieff expired at the end of the 2005-06 financial year and was not formally extended until December 2006. As a result, there was no internal audit provider for most of the financial year and no formal internal audit plan for 2006-07 was produced in time to be relied upon for external audit planning purposes.

Performance

We carried out an overview of the arrangements in relation to the duty to deliver best value and efficiency in its operations. Our review found that FRS does not yet have a formal approach in place to demonstrate that it achieves best value and efficiency in its operations.

We note that FRS achieved all of its 2006-07 performance targets set by Scottish Ministers .

The Way Forward

Our findings and recommendations are summarised in an Action Plan (Appendix A) that accompanies this report. The Action Plan has been agreed with management and incorporates the management response to audit recommendations.

The report includes some specific recommendations to strengthen internal controls. It is the responsibility of the Accountable Officer to decide the extent of the internal control system appropriate for the management of FRS.

Acknowledgements

We would like to take this opportunity to thank the staff who have been involved in this review for their assistance and co-operation.

This report is part of a continuing dialogue between FRS and Grant Thornton UK LLP and is not, therefore, intended to cover every matter which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in systems and work practices at FRS.

The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place on. The report will be submitted to the Auditor General for Scotland and will be published by him on his website at www.audit-scotland.gov.uk.

Grant Thornton UK LLP
19 December 2007

Financial Statements

Our Responsibilities

We audit the financial statements and give an opinion on whether:

- they give a true and fair view, in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers, on the state of affairs of FRS as at 31 March 2007 and of its net expenditure, recognised gains and losses and cash flows for the year then ended;
- they, and the part of the Remuneration Report to be audited, have been properly prepared in accordance with the Government Financial Reporting Manual (FReM) and directions made thereunder by the Scottish Ministers; and
- in all material respects the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

We also review the Statement on Internal Control by:

- considering compliance with Scottish Executive guidance;
- considering the adequacy of the process put in place by the Accountable Officer to obtain assurances on systems of internal control; and
- assessing whether disclosures in the Statement are consistent with the information emerging from our normal audit work.

Overall Conclusion

We have given an unqualified opinion on the statutory accounts of FRS for the 2006-07 financial year. We are able to conclude that the statutory accounts give a true and fair view of FRS' financial position for the year ended 31 March 2007 and that, in all material respects, expenditure and receipts were incurred or applied during the year are in accordance with applicable enactments and relevant guidance.

Standard of accounts and supporting papers

An early draft of the financial statements was received for audit on 18 June 2007. Our audit fieldwork commenced on 25 June when a revised draft was made available. Our audit identified a requirement for a significant number of presentational amendments to that draft. We also recommended material changes to the disclosures made in the Statement on Internal Control. The nature of the amendments required to be made to the accounts extended the audit timetable for completion.

We have recommended that management undertake a detailed review of the 2007-08 draft financial statements prior to presentation for audit to improve the quality of the draft financial statements, and increase the efficiency of the audit process.

Refer Action Plan Point 1

FRS is required to submit a 'consolidation pack' to the Scottish Government which summarises its financial results and enables completion of the consolidated Scottish Government accounts within agreed timescales. FRS did not submit its 2006-07 consolidation pack in accordance with the agreed timetable. FRS should ensure that procedures are in place to meet deadlines for the submission of the 'consolidation pack' within agreed timescales for the 2007-08 financial year.

Refer Action Plan Point 2

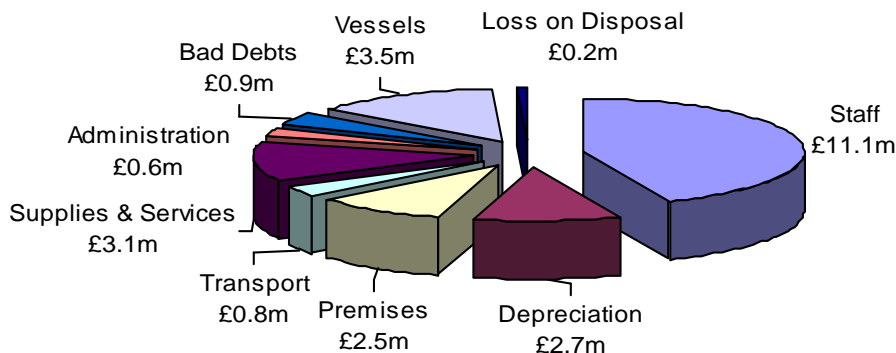
Financial Performance

The Operating Cost Statement records gross expenditure of £25.4 million for the year ending 31 March 2007, an increase of £2.6 million (11%) from the previous year. Net expenditure was £23 million against a budget of £22.864 million representing a small overspend of £136k (0.6%). The main reasons for the increase in expenditure are:

- an increase in the bad debt provision by £0.938 million relating to EU projects where FRS is engaged by the UK Department of Environment, Food and Rural Affairs ;
- increase in vessel operating costs by £0.305 million, reflecting higher activity by the fishery research vessels and increase in the price of fuel;
- an increase in premises costs by £0.468 million, reflecting refurbishment works carried out at the Freshwater laboratory; and
- a loss on disposal of fixed asset of £0.161 million.

A more detailed analysis FRS's gross expenditure is contained in Figure 1 below:

Figure 1 - Analysis of 2006-07 Gross Expenditure



The accounts include a provision approaching £1 million in relation to amounts receivable in respect of work undertaken by FRS as an agent of the Department for Environment, Food and Rural Affairs (DeFRA) on behalf of the European Union (EU). This provision reflects FRS's judgement that DeFRA will be unable to meet EU compliance requirements in order to release payments to fund the work undertaken. The costs of this work, dating back to the 2003-04 financial year, will require to be funded directly by the Scottish Government. FRS has drawn this matter to the attention of both the Scottish Government and DeFRA.

During the year FRS incurred capital expenditure of £3.1 million against its capital budget of £5.4 million, representing an underspend of £2.3 million (43%) due largely to delays to the build schedule of the new *Alba Na Mara* vessel (which accounted for £1.8 million of total capital expenditure incurred during the financial year) and in acquiring the land to develop the FRS estate. The procurement of the new *Alba Na Mara* vessel is anticipated to cost £4 million and FRS expect to take delivery in early 2008.

The key financial target of FRS is to fulfil the service level agreement with the Scottish Executive Environment and Rural Affairs Department (SEERAD) within the running costs allocated, and to recover agreed costs for charged services. The Agency was successful in managing its resources so as to deliver its research services in line with 2006/07 running costs allocations.

Statement on Internal Control

The Statement on Internal Control (SIC) sets out the arrangements established, and operated, for risk identification and management, proposed future development of arrangements, and review of effectiveness of the system of internal control.

The draft SIC was amended to reflect control weaknesses identified in FRS's arrangements for fixed asset management and in internal audit arrangements. Following our review, we are satisfied that:

- the revised SIC complies with Scottish Executive guidance;
- the process put in place by the Accountable Officer to obtain assurances on systems of internal control is adequate; and
- that the contents of the Statement are consistent with the information emerging from our normal audit work.

ISA 260: Communication of Audit Matters to Those Charged with Governance

Our responsibilities in relation to the communication of audit matters to those charged with governance are covered in the International Standard on Auditing 260 and outcomes against the requirements of the Standard was reported to management in our report dated 23 August 2007. The main points arising were:

- a net increase of £0.292 million was made to the provision for bad debts to reflect increased uncertainty over the receipt of contract income from the European Union;
- In addition, a significant number of presentational amendments to the draft financial statements were recommended and accepted by management during the audit process. These changes are reflected in the published financial statements; and
- Note 6 of the accounts records the disposal of assets with a gross book value of £5.866 million, but which have an immaterial net book value. Some of these assets were identified as surplus to requirements in prior years, but continue to be retained by FRS. The classification of these assets as disposals is, therefore, inaccurate. As the assets are of immaterial net book value, there is no impact on the reported financial position of FRS.

Governance

Introduction

Corporate governance is the system by which organisations direct and control their functions and relate to their stakeholders, and incorporates the way in which an organisation manages its business, determines strategy and objectives and goes about achieving those objectives. It is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation. Three fundamental principles of corporate governance apply equally to all public sector bodies - openness, integrity and accountability.

As part of our 2006-07 audit, we assessed the adequacy of FRS's governance arrangements against good practice standards for the public sector. We examined:

- the structures and processes for decision making;
- risk management and systems of internal control;
- arrangements for the prevention and detection of fraud and irregularities;
- standards of conduct, integrity and openness; and
- reporting arrangements and monitoring of the overall financial position.

We also reviewed and reported on the existence and operating effectiveness of key financial controls, specifically: income and accounts receivable, fixed assets management, expenditure and accounts payable and the general ledger.

Corporate governance arrangements

We found that the Agency's governance arrangements are generally operating adequately, however, we identified some areas where further work is required to meet the requirements of the Scottish Public Finance Manual (SPFM), in particular:

- the audit committee should meet at least three times per year;
- we recommend that membership of the Agency's audit committee be limited to non executives where possible; and
- existing arrangements for identifying financial and external risks should be reviewed.

Key controls

We found that the systems of internal controls are generally operating adequately, however, we found significant control weaknesses covering the operation of the Agency's fixed asset register, including:

- the fixed asset register is not regularly reconciled to the general ledger;
- there is no programme of fixed asset verification to ensure the completeness and accuracy of the fixed assets register; and
- FRS carried out an exercise in the 2005-06 financial year that identified fixed assets having a gross cost of £5.72 million and net book value of £160k which were recorded in the fixed asset register but had either been disposed of in a prior period, could not be located or were surplus to operational requirements. The Agency has accounted for these assets as disposals in its 2006-07 accounts. We are satisfied that there is no material impact on the accounts in relation to this matter, however, it does represent a significant historic governance issue.

Refer Action Plan Point 3

Contracting Arrangements

As part of our audit of FRS's financial statements, we identified potential procedural weaknesses in contracting arrangements for contracts awarded to a number of Fisheries Trusts. These contracts were awarded in two tranches of £300,000 during the 2006-07 financial year on behalf of the Scottish Executive.

We found that FRS had not publicised these contracts and did not take additional procurement advice before proceeding to finalise them. FRS sought clarification from the Office of the Solicitor to the Scottish Executive in response to the audit concerns on this issue. This advice confirmed that Fisheries Trust contracts related to the purchase of information and not services and, therefore, fell below the threshold set for EU procurement compliance. In our view, this approach increased the risk of non-compliance with EU procurement guidelines in the award of these contracts.

Refer Action Plan Point 4

Internal audit

The Agency's internal audit contract with Scott Moncrieff expired at the end of the 2005-06 financial year and was not formally renewed until December 2006. As a result, there was no internal audit provider for most of the financial year and no formal internal audit plan was produced until late in the financial year. We have, therefore, been unable to rely on the work of internal audit for the purposes of our 2006-07 financial statements audit.

FRS has appointed Deloitte as the internal audit provider for 2007-08, and we are satisfied that adequate internal audit arrangements are now in place. We have recommended, however, that FRS review its tendering procedures to ensure future tendering arrangements for recurring services contracts (such as the internal audit contract) are planned well in advance to protect service continuity.

Refer Action Plan Point 5

Performance

Introduction

Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our annual audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness, and best value in the use of resources.

Best value

The Chief Executive has a duty to ensure public resources are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure best value in the use of resources. A review of best value arrangements for FRS was issued in 2005-06, which reported that FRS is generally complying the requirements.

Our review found that FRS does not yet have a formal approach in place to demonstrate that it achieves best value and efficiency in its operations. In light of the Government's renewed efficiency drive following the recent spending review, it is essential that FRS develop its performance management arrangements.

Action plan point 6

Ministerial Targets

During the year, FRS achieved all of its performance targets set by Scottish Ministers. A summary of performance against Ministerial Targets for the year ending 31 March 2007 is contained in Appendix B. We note that the information used to measure performance against Ministerial Targets is not currently reviewed by internal audit, and no assurance statement is given in relation to the accuracy of the calculation and reporting of performance measures.

Action plan point 7

Grant Thornton UK LLP

19 December 2007

Appendix A – Action Plan

No	Finding	Risk	Recommendation	Management Response	Implementation date
Preparation of the financial statements					
1	Our audit identified a requirement for a significant number of presentational amendments and monetary adjustments (many material in nature) to the draft accounts.	Medium	FRS's financial statements should be subject to a formal supervisory review prior to submission for audit.	FRS undertook an in-depth review of the areas of highest risk prior to releasing the financial statements for audit. Consequently, adjustments proposed by GT amounted to a credit of £15k in the income and expenditure account. A further adjustment of £268k, (a reduction in income from the DCR contract) was made following lengthy consideration and discussion with GT; the issue involved a subjective assessment by FRS management and GT, and by its nature could not be determined by FRS alone.	Will be Implemented formally for 2007/08 audit.
2	FRS was unable to submit its 2006-07 consolidation pack in accordance with the agreed timetable.	Medium	FRS should ensure that procedures are in place to meet deadlines for the submission of the 'consolidation pack' within agreed timescales for the 2007-08 financial year.	We will ensure that the timetable and requirements are fully understood by all relevant staff in 2007/08.	31 March 2008

No	Finding	Risk	Recommendation	Management Response	Implementation date
Fixed Assets					
3	FRS carried out an exercise in the 2005-06 financial year that identified £5.72 million of fixed assets which are recorded in the fixed asset register but had either been disposed of in a prior period, could not be located or were surplus to operational requirements. The Agency has accounted for these assets as disposals in its 2006-07 accounts.	High	FRS should review its arrangements for recording and monitoring fixed assets and should take immediate action to dispose of asset regarded as surplus to requirements.	FRS has reviewed its procedures for monitoring fixed assets, and as a result has identified assets with a cost of £5.72 million and NBV of £160k that should have been treated as disposals in previous years. There is now a continuous process of asset verification.	Implemented
Contracts and tendering					
4	As part of our audit of FRS's financial statements, we identified potential procedural weaknesses in contracting arrangements for contracts awarded to a number of Fisheries Trusts. FRS's approach increased the risk of non-compliance with EU procurement guidelines in the award of these contracts.	Medium	FRS should review its procedures for awarding contracts to ensure they continue to comply with EU, and other best practice, guidance.	Not accepted: The contracts with the fisheries trusts were awarded in accordance with SPD and EU procurement rules. FRS management believes that appropriate advice was sought at each stage, and that actions taken were appropriate and compliant with procurement rules. This was confirmed by OSSE (Office of the Solicitor to the Scottish Executive) on request of external audit.	The contracts with the Fisheries Trusts were awarded in accordance with the policy of the then SE. FRS will not enter into similar contracts in future
5	The Agency's internal audit contract with Scott Moncrieff expired at the end of the 2005-06 financial year and was not formally renewed until December 2006. As a result, there was no internal audit provider for most of the financial year and no formal internal audit plan was produced.	High	FRS should review its tendering procedures to ensure future tendering arrangements for recurring services contracts (such as the internal audit contract) are planned well in advance to protect service continuity.	Re-tender exercise was planned well in advance but was hindered by insufficient procurement resources to deal with the volume of EU tenders at that particular time. Additional resources have been made available but this needs to be reviewed in light of threshold changes.	Implemented

No	Finding	Risk	Recommendation	Management Response	Implementation date
Performance					
6	FRS does not yet, have a formal approach in place to demonstrate that it achieves best value and efficiency in its operations.	High	FRS should formalise its approach to demonstrating the achievement of best value and efficiency in its operations in line with Scottish Government guidance.	FRS is currently developing a balanced scorecard which will be used to identify key business processes and measure their efficiency and effectiveness.	February 2008
7	The information used to measure FRS's performance against Ministerial targets is not currently reviewed by internal audit, and no assurance statement is given in relation to the accuracy of the calculation and reporting of performance measures.	Low	FRS should consider the need to obtain independent assurance on the accuracy of data used to measure and report its performance against set targets.	FRS will liaise with internal audit for independent verification of the accuracy of performance measures	January 2008

Appendix B – Summary of Performance against Key Targets

Key performance targets

MEASURES	2002-03	2003-04	2004-05	2005-06	2006-07		
	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Target</u>	<u>Actual</u>	<u>Achieved</u>
Delivery Of Service							
Achievement of performance targets set in the schedules to the service level agreement	93%	95%	96%	94%	95%	95%	Yes
Achievement of agreed milestones for Research and Development projects	88%	84%	89%	80%	86%	90%	Yes
Maintain FRS' publication output:							
• Number of staff (scientists only from 03-04)	318	245	229.5	226.4	-	221	n/a
• Peer reviewed papers (+ ICES papers)	154	204	156	266	-	132	n/a
• Published reports	85	156	138	60	-	154	n/a
• Publications/member of staff (scientific staff only from 03-04)	0.75	1.5	1.5	1.4	1.3	1.3	Yes
Produce information leaflets for stakeholders; major articles in the fishing press; Annual Stock Assessment information.	50 12 -	24 10 -	34 12 -	22 13 -	22 10 -	32 12 -	Yes
Quality of Service							
To implement the BBSRC/DEFRA/FSA/ NERC Joint Code of Practice for Research to the Agency's research programmes.	-	-	-	Pilot completed 100%	100% of new research projects.	100%	Yes
To carry out peer review on research projects on completion.	-	-	-	-	Pilot system on 3 completed projects	100%	Yes