



Fisheries Research Services

Report on the 2007-08 Audit

18 July 2008

Contents		Page
1	Executive Summary	1
2	Financial Statements	3
3	Governance	7
4	Performance	8
Appendices		
	Appendix A - Action Plan	10
	Appendix B - Communication of audit matters to those charge with governance	12

1 Executive Summary

Introduction

We have audited the financial statements of Fisheries Research Services (FRS) for the year ending 31 March 2008 and examined aspects of FRS's performance and governance arrangements. This report sets out our key findings.

Financial Statements

We have given an unqualified opinion on both FRS's financial statements for 2007-08 and on the regularity of transactions undertaken during the financial year. During the year, FRS incurred net expenditure of £23.7 million against a net revenue budget of £27.5 million, representing an underspend of £3.8 million (14%).

The budget underspend primarily relates to lower than expected running costs, particularly in relation to the operation of vessels and higher than expected income from the European Union.

FRS incurred capital expenditure of £4.1 million during the year against a budget of £4.6 million, representing a small underspend of £0.5 million. In February 2008, FRS took delivery of its new research vessel, Alba na Mara which was delivered on time and within budget at £3.9 million.

FRS's draft financial statements were presented for audit on 12 June 2008, well in advance of the prior year. The draft accounts and supporting working were of a good standard and this helped the audit progress smoothly..

Governance

We found that FRS's governance arrangements operated well and within a generally sound control environment, commensurate with the scale of FRS's operations. We note, however, that membership of FRS's audit committee is not restricted to non-executive members, and this does not comply with the guidance contained within the Scottish Public Finance Manual. FRS has, however, recently taken action to recruit a new non-executive member to its audit committee and this will strengthen governance arrangements going forward.

Our review of the internal audit function confirms that it complies with Government Internal Audit Standards and, as a result, we have been able to place reliance on their work for the purposes of our audit.

Performance

We carried out an overview of FRS's arrangements in relation to the duty to deliver best value and efficiency in their operations. The Agency has undertaken a range of improvement activities during the year but, as we reported in 2006-07, has not yet developed a formal process for delivering best value and has not yet developed a systematic process for measuring and monitoring efficiency.

The Agency is required to monitor its performance throughout the year against key targets set by Ministers. While most of the targets were met, the Research and Development milestones and delivery of the Schedule of Services targets were narrowly missed, mainly as a result of a reduction in the Agency's staff numbers.

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 FRS and incorporates the Management Board's response to audit recommendations.

The report includes some specific recommendations to strengthen internal controls. It is the responsibility of FRS's management to decide the extent of the internal control system appropriate to the organisation.

Acknowledgements

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

This report is part of a continuing dialogue between FRS and Grant Thornton 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 FRS's systems and work practices.

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
18 July 2008

2 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 2008 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 (FRM) 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 Government 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 are able to conclude that FRS's financial statements give a true and fair view of the financial position for the period from 1 April 2007 to 31 March 2008 and that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and relevant guidance.

Standard of accounts and supporting papers

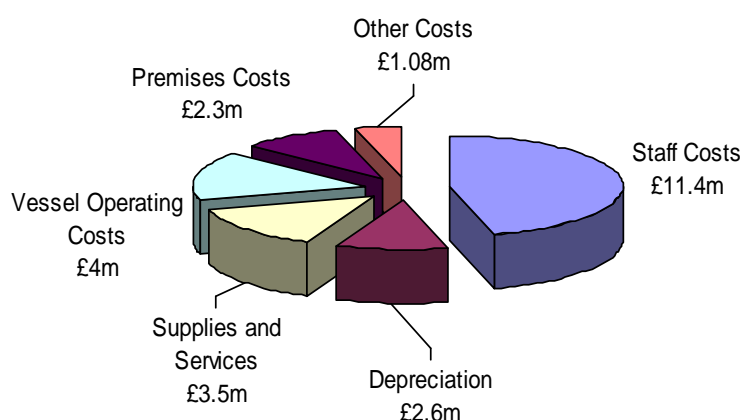
FRS's draft financial statements were presented for audit on 12 June 2008, well in advance of the prior year. The standard of the draft accounts and supporting working prepared by the finance team were also significantly improved and this helped the audit progress smoothly..

Financial Performance

FRS's Operating Cost Statement for the year records net expenditure of £23.7 million against a net revenue budget of £27.5 million representing an underspend of £3.8 million (14%). The budget underspend primarily relates to lower than expected running costs, particularly in relation to the operation of vessels and higher than expected income from the European Union.

Staff costs accounted for 49.9% of gross expenditure with enforcement costs (29.7%), depreciation and capital charges (17.9%) and accommodation costs (1.5%) accounting for the remainder. A more detailed analysis of FRS's 2007-08 expenditure is shown in figure one below:

Figure One - Analysis of FRS 2007-08 expenditure



FRS incurred capital expenditure of £4.1 million during the year against a budget of £4.6 million, representing a small underspend of £0.5 million. In February 2008, FRS took delivery of its new research vessel, Alba na Mara which was delivered on time and within budget at £3.9 million.

Income from EU Contracts

In the 2006-07 accounts, FRS created a bad debt provision of £692k in respect of uncertainty over the recoverability of income relating to the Data Collection Regulations (DCR) contract for work performed in 2004 and 2005. During 2007/08, however, FRS received all income due under the DCR contract for these years.

In 2007-08, FRS again established a bad debt provision for income due under the DCR contract for work performed during 2006 and 2007. The bad debt provision also included a £250k adjustment for income due in relation to work performed in 2007-08 but considered unlikely to be received. We queried whether this level of provision was appropriate in light of recovery experience.

In response, FRS has revised its approach to recognise that the risk profile in relation to recovery of income under the DCR contract includes the following factors:

- **Legislative:** European Union (EU) Articles requiring service provider compliance with terms for reimbursement of expenditure;
- **Historical:** the history of debt recovery from the Department for Rural Affairs (DEFRA);
- **Legal:** to date FRS has been unable to secure a Memorandum of Understanding with DEFRA regarding debt recovery;
- **Age profile:** older contractual income is considered less likely to be recoverable; and
- **Instalment profile:** the recovery of 'second instalment' income is more uncertain due to stricter EU technical and financial requirements.

FRS concluded that the provision for bad debt should be revised on the following basis:

- 60% risk of irrecoverable income for 2006;
- 40% risk of irrecoverable income for 2007; and
- 10% risk of irrecoverable income for 2008.

The bad debt provision has therefore been amended from £1,038k to £474k.

A minor amendment was also made to increase the accrued income relating to 2008 for the DCR contract from £250k to £261k.

In our view, the revised methodology adopted by FRS provides a more systematic basis for calculating the bad debt provision. However, a further review of the percentages adopted for the provision for each year should be subject to further review in light of recovery experience in 2008-09.

Refer Action Plan Point 1

Escrow Bank Account

During our review of the project to build the new research vessel, *Alba na Mara*, we noted that a separate bank account is in operation to pay the ship builders and design team. The balance (around £45k at 31 March 2008) was not included in cash or prepayments in the draft accounts. An adjustment has been made to reflect this asset within the accounts.

Refer Action Plan Point 2

Indexation on Land and Buildings

An adjustment was required to reflect indexation on Land and Building fixed assets. Indexation had been applied to the assets within Britannia, the fixed assets register, but this had not been adjusted within the accounts or the general ledger.

Refer Action Plan Point 3

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. Outcomes against the requirements of the Standard are reported in Appendix B to this report. In this context, all the errors we identified were adjusted within the accounts.

3 Governance

Introduction

Sound corporate governance is central to demonstrating Best Value, 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. Good governance means:

- focusing on the organisation's purpose and on outcomes for citizens and service users;
- performing effectively in clearly defined functions and roles;
- promoting values for the whole organisation and demonstrating the values of good governance through behaviour;
- taking informed, transparent decisions and managing risk;
- developing the capacity and capability of the governing body to be effective; and
- engaging stakeholders and making accountability real.

As part of our 2007-08 audit, we assessed the adequacy of FRS's corporate governance arrangements against the Scottish Public Finance Manual. 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 FRS's overall financial position.

Key outcomes from our 2007-08 audit

We found that FRS's governance arrangements operated well and within a generally sound control environment, commensurate with the scale of FRS's operations. We note, however, that membership of the FRS's audit committee is not restricted to non-executive members, and this does not comply with the guidance contained within the Scottish Public Finance Manual. The FRS has, however, recently taken action to recruit a new non-executive member to its audit committee and this will strengthen governance arrangements going forward.

Refer Action plan point 4

Our review of the internal audit function confirms that it complies with Government Internal Audit Standards and, as a result, we have been able to place reliance on their work for the purposes of our audit.

4 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 in the use of resources.

The Chief Executive, as Accountable Officer for FRS, 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.

Performance Management

FRS has been set 15 key performance targets by Scottish Ministers covering the range of its functions. Figure two below, shows the Agency's performance against these targets:

Figure Two - Performance against Operational Targets

Indicator	Target	Actual	Target Met
Delivery of Service			
Achievement of performance targets in Service Level Agreement	95%	94%	No
Achievement of agreed milestones for research and development projects	86%	85%	No
Publication Output			
Publication/member of staff	1.3	1.3	Yes
produce information leaflets for:			
• stakeholders	1.5	22	Yes
• major articles in fishing press	12	30	
• annual stock assessment information	1	1	

Indicator	Target	Actual	Target Met
Quality of Service			
Implement the BBSRC/DEFRA/FSA/NERC Joint Code of Practice for Research to Agency programmes	100% of new research projects	100% (13 projects)	Yes
Carry out peer review on research projects on completion	70% of all projects on completion	100% (11 projects)	Yes
Maintain and achieve accreditation to ISO standard for specified areas of FRS work	Present 3 new methods for accreditation to ISO standard	Accreditation completed 100% (3 new methods submitted)	Yes
Establish sustainable feedback system to measure stakeholder satisfaction and carry out survey	100%	100%	Yes
Establish sustainable feedback system to measure customer satisfaction and carry out survey	100%	100%	Yes
Efficiency			
Full economic cost (FEC) to be recovered from external customers (other than those agreed to be undertaken at marginal or shared cost)	94%	94.6%	Yes
Restrict administrative staff costs as a % of total staff costs	18%	18%	Yes
Cash releasing efficiency gains (% of cost)/contribute to Efficient Government Initiative through cash and time releasing savings	5%	5%	Yes
Utilise research vessels efficiently			
Contracted days at sea	96%	94%	No
Daily costs of <i>Scotia</i> (FEC)	£11,783	£11,422	Yes
Daily costs of <i>Clupea</i> (FEC)	£2,784	£3,675	No

The Agency did not, therefore, achieved four of its operational performance targets during 2007-08, although in all cases performance was only marginally below target.

Refer Action plan point 5

Best value and efficient government

We carried out an overview of FRS's arrangements in relation to the duty to deliver best value and efficiency in their operations. The Agency has undertaken a range of improvement activities during the year but, as we reported in 2006-07, has not yet developed a formal process for delivering best value or for measuring and monitoring efficiency.

Refer Action plan point 6

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18 July 2008

Appendix A - Action Plan

No	Finding	Risk	Recommendation	Management Response	Implementation date
Financial Statements					
1	In our view, the revised methodology adopted by FRS provides a more systematic basis for calculating the bad debt provision. However, a further review of the percentages adopted for the provision for each year should be subject to further review in light of recovery experience in 2008-09.	Medium	FRS should re-evaluate its bad debt provision annually in light of recovery experience.	The Agency will review its bad debt provision when preparing the draft 2008-09 accounts.	May 2009
2	We noted that a separate bank account is in operation to pay the ship builders and design team. The balance (around £45k at 31 March 2008) was not included in cash or prepayments in the draft accounts.	Medium	The Agency should ensure all bank accounts are correctly identified, regularly reconciled and reported through management and financial accounts.	This bank account is now been included in all financial reporting.	Immediate
3	Indexation had been applied to the assets within Britannia, the fixed assets register, but this had not been adjusted within the accounts or the general ledger.	Medium	The Agency should ensure all assets are subject to indexation in line with iFRM requirements.	Agreed - now resolved through the Britannia system.	May 2009.

Appendix A - Action Plan

No	Finding	Risk	Recommendation	Management Response	Implementation date
Governance					
4	Membership of FRS's audit committee is not restricted to non-executive members, and this does not comply with the guidance contained within the Scottish Public Finance Manual.	Medium	FRS should review its audit committee procedures to ensure they meet good practice guidelines.	FRS has recently taken action to recruit a new non-executive member to its audit committee and this will strengthen governance arrangements going forward. A full review of audit committee arrangements will be delayed until consultation on a new marine management organisation are finalised.	May 2009
4	Recent staff movements have significantly reduced the finance capacity within the Agency. This has restricted the ability of the finance team to produce meaningful and timely management accounting information.	Medium	Whilst we recognise that the Agency is seeking to recruit additional staff, we recommend that this capacity gap is addressed as a matter of priority.	The Agency has experienced problems recruiting staff into vacant positions due to supply issues. Plans are in place to fill both vacancies and the team should be at complement by 1 September 2008.	1 September 2008

Appendix A - Action Plan

No	Finding	Risk	Recommendation	Management Response	Implementation date
Performance					
5	The Agency did not meet four of its key performance indicator targets during the financial year.	Medium	The Agency should take action to review and improve its performance to ensure it meets all performance targets for 2008-09.	The Agency has reviewed its performance during the financial year and will ensure it achieves all performance targets for 2008-09.	Immediate
6	FRS has not yet established a formal approach to best value and has not yet developed a systematic process for measuring and monitoring efficiency.	Medium	FRS should formalise its approach to achieving best value and efficiency in its operations.	The Agency has embedded best value into its culture and will formalise its approach during the year.	June 2009

Appendix B- Communication of audit matters to those charged with governance

ISA 260 – Communication of audit matters to those charged with governance

Under ISA 260, we are required to consider matters of governance interest that arise from the audit of the financial statements and communicate them with those charged with governance. The areas considered are as follows:

- a) Relationships that may bear on Grant Thornton’s independence and the integrity and objectivity of the audit engagement lead and audit staff;
- b) The overall approach to the audit including any limitations thereon, or any additional requirements;
- c) The selection of, or changes in, significant accounting policies and practices that have, or could have a material effect on the entity’s financial statements;
- d) The potential effect on the financial statements of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements;
- e) Audit adjustments, whether recorded or not by the entity that have, or could have a material impact on the entity’s financial statements; and
- f) Those uncorrected misstatements aggregated by the auditor during the audit that were determined by management to be immaterial both individually and in aggregate to the financial statements as a whole.

Key Findings

We summarise our key audit findings in relation to the above areas.

Ref	Area	Key Messages
A	Independence	<p>We are able to confirm our independence and objectivity as auditors and note the following:</p> <ul style="list-style-type: none"> • we are independently appointed by Audit Scotland; • we comply with the Auditing Practices Board’s Ethical Standards; and • we have not performed any non Code of Audit Practice (the Code) or advisory work during the year.

Appendix B- Communication of audit matters to those charged with governance

Ref	Area	Key Messages
B	Approach to the audit	<p>Our approach to the audit was set out in our 2007-08 audit plan. We have planned our audit in accordance with International Auditing Standards and the Code. Other key factors to highlight include:</p> <ul style="list-style-type: none"> • we consider the materiality of items in the financial statements both in determining the approach to audit them and in determining the impact of any errors; • we have been able to place appropriate reliance on the key accounting systems operating at the FRS for final accounts audit purposes only; and • we have been able to place reliance on the work of internal audit in respect of the key accounting systems.
C	Accounting policies and practices	<p>Management agreed to our request for additional disclosure in respect of income recognition to reflect the receipt of compensation from the delayed acquisition of capital assets in 2007-08.</p> <p>Following this, we consider that FRS has adopted appropriate accounting policies in the areas covered by our testing. These policies were in accordance with the Government Financial Reporting Manual (FRM).</p> <p>The Board has considered and confirmed that FRS remains a going concern. The Board is asked to confirm this through the Letter of Representation.</p>

Appendix B- Communication of audit matters to those charged with governance

Ref	Area	Key Messages
D	Material risks and exposures	<p>The Board has considered and confirmed that FRS has no material risks and exposures, which should be reflected in the financial statements.</p> <p>The Board is asked to confirm this in the Letter of Representation.</p>
E	Audit adjustments and unadjusted errors	<p>We identified several disclosure amendments and reclassifications to improve the presentation of the accounts.</p> <p>These are outlined below. There were no material errors that were not adjusted in the accounts.</p>

Summary of adjusted audit differences

This is a summary of audit differences processed by FRS during the course of our audit.

	Income & Expenditure account		Balance Sheet	
	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Adjustments affecting reported results				
Movement in bad debt provision		564	564	
Revision to EU Accrued Income		11	11	
Recognition of Escrow bank account			45	45
Indexation to Land and Buildings			434	434

Appendix B- Communication of audit matters to those charged with governance

Summary of unadjusted audit differences

This is a summary of unadjusted audit differences identified during the course of our audit.

Two minor amendments were noted in relation to EU Contract income. In one case it was found that income totalling £35k was not yet due as a result of delays to work caused by adverse weather conditions. Late amendments meant that two amounts totalling £8k were highlighted as being due at the year end.

These differences have not been amended, as they are not material to the financial statements.

	Income & Expenditure account		Balance Sheet	
	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Adjustments affecting reported results				
Prior year adjustment to recognise Escrow bank account			50	50
Amendments to EU Contract Income	27			27



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