

A REPORT BY THE AUDITOR GENERAL FOR SCOTLAND UNDER SECTION 22(3) OF THE
PUBLIC FINANCE AND ACCOUNTABILITY (SCOTLAND) ACT 2000**THE 2003/04 AUDIT OF FOREST ENTERPRISE SCOTLAND**

1. I have received the audited accounts of Forest Enterprise Scotland for the year ended 31 March 2004. The auditor's report on the accounts is not qualified but I have decided to issue this report to bring to the Parliament's attention the agency's financial performance in its first year of operations.
2. I submit these accounts and the auditor's report in terms of sub-section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report which I have prepared under sub-section 22(3) of the Act.
3. Prior to devolution, the Forestry Commission operated with a remit across Great Britain. Forest Enterprise was an executive agency of the Forestry Commission with responsibility for the management of the forest estate. Following the recommendations of the Forestry Devolution Review, Forestry Commission Scotland was established in April 2003 to serve as the forestry department of the Scottish Executive. The agency was also trisected in April 2003 to create separate agencies in Scotland, England and Wales. 2003/04 was, therefore, the first year of operations of Forest Enterprise Scotland.
4. The role of Forest Enterprise Scotland is to manage the Scottish forest estate in accordance with the economic, environmental and social objectives set by the Scottish Ministers. Its main trading activity is to harvest and market timber on a commercial basis. In 2003/04 sales of timber amounted to £32.3 million on total operating income of £37 million. Forestry Commission Scotland sets financial targets for Forest Enterprise Scotland which reflect the net loss made by Forest Enterprise Scotland on its operating activities and the cash consequences of that deficit plus the net cost of other Forest Enterprise Scotland activities. Forestry Commission Scotland funds Forest Enterprise Scotland's cash deficit.
5. Forestry Commission Scotland set Forest Enterprise Scotland targets to achieve an operating deficit of no more than £17.0 million and a cash deficit of no more than £23.2 million in 2003/04. The agency reported an operating deficit of £23.894 million and a cash deficit of £23.240 million. Forest Enterprise Scotland therefore missed both these targets, although the actual operating deficit includes a loss of £6.358 million on the revaluation of assets which was not included in the targets for 2003/04. Without this figure, the operating deficit would have been £17.536 million.
6. The financial performance of Forest Enterprise Scotland is closely linked to the income it generates from timber sales. Some 80% of the UK's timber requirements are imported. The Forestry Commission provides about half the remaining balance at prices which are determined largely by world timber markets. Timber prices are currently at or near their lowest point ever in real terms and, consequently, Forestry Commission Scotland funding of Forest Enterprise Scotland is increased. Forestry Commission Scotland expects that Forest Enterprise Scotland will continue to require deficit funding for the foreseeable future.



ROBERT W BLACK
Auditor General for Scotland
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