



SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW



Scottish Screen
National Lottery Distribution Fund
Annual Report to the Joint Board and the
Auditor General for Scotland
2007/08

August 2008

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1 Summary

Governance

- Scottish Screen National Lottery Distribution Fund (SSNLDF) will be affected by the proposed combination of Scottish Screen and the Scottish Arts Council. There is an expectation that SSNLDF's operations and activities will continue under the Creative Scotland banner, once the new body is established.
- The Creative Scotland Bill fell at stage one of the parliamentary review process on 18 June 2008. The Scottish Government plan to reintroduce the Bill to the Scottish Parliament. Creative Scotland was expected to be established by 1 April 2009 but there may be a delay in this happening.

Performance

- Audit Scotland have continued its roll-out of its Best Value reviews in the central government sector and have performed a number of Best Value reviews of Financial Management arrangements in 2007/08. We have not performed this review at SSNLDF but we will review Audit Scotland's overall findings as part of our 2008/09 audit.
- SSNLDF continues with the development of the new Client Relationship Management (CRM) system. The system allows for robust monitoring of project performance and provides increased functionality to inform future decision making.

Finance

- Our audit opinion on the truth and fairness of the annual accounts and on the regularity of transactions is unqualified. The statutory deadline for submitting the annual accounts to the Scottish Parliament of 31 December 2008 will be achieved.
- SSNLDF incurred total expenditure of £2.987 million and received total income of £2.619 million, including £2.325 million proceeds from the National Lottery Fund. This has resulted in a decrease in the fund of £368,000 in 2007/08. SSNLDF reported a balance of £5.496 million held with National Lottery Distribution Fund as at 31 March 2008, and a net asset position of £3.035million.

Conclusion

This report concludes the 2007/08 audit of SSNLDF, which we have performed in accordance with the Code of Audit Practice issued by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

This report has been discussed and agreed with the Chief Executive and Chief Operating Officer/Company Secretary. We would like to thank all members of management and staff who have been involved in our work for their co-operation and assistance during our audit.

Scott-Moncrieff
August 2008

2 Introduction

2.1 Auditor General and Audit Scotland

The Auditor General for Scotland is responsible for reporting to the Scottish Parliament on how public bodies spend public money, manage their finances and achieve value for money in the use of public funds. In discharging this responsibility the Auditor General appoints central government auditors and sets the terms of their appointment.

Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out his statutory functions, including preparing a Code of Audit Practice which sets out the role and responsibilities of the external auditor.

2.2 Audit appointment

Scottish Screen has been appointed to distribute National Lottery funds, under the National Lottery etc Act 1993 (as amended), for the purposes of supporting and developing the screen industry and related activities in Scotland. Scottish Ministers guidance requires Scottish Screen to prepare separate statements of accounts for its Scottish Screen National Lottery Distribution Fund (SSNLDF).

The Auditor General has appointed Scott-Moncrieff as the auditor of SSNLDF for the five year period 2006/07 to 2010/11. Scott-Moncrieff is not the appointed auditor of either Scottish Screen Limited or its subsidiary – Scottish Screen Enterprise Limited.

2.3 Independence and ethical standards

Ethical Standard 1 – *Integrity, objectivity and independence*, issued by the Auditing Practices Board (APB), requires external auditors to ensure that the Audit Committee is appropriately informed on a timely basis of all significant facts and matters that bear upon the auditors' objectivity and independence.

We confirm that we have complied with APB Ethical Standards throughout our audit and that, in our professional judgement, we have remained independent and our objectivity has not been compromised in any way. In particular:

- a) There are and have been no relationships between Scott-Moncrieff and Scottish Screen, its directors and senior management that may reasonably be thought to bear on our objectivity and independence, and
- b) Scott-Moncrieff has not provided any consultancy or non-audit services to Scottish Screen.

2.4 Key risks

Our audits are risk based. This means that we focus our resources on the areas of highest priority or risk. The key audit issues identified for the 2007/08 audit were summarised in our external audit plan which was presented to the Audit Committee on 26 October 2007. These audit issues were:

- Governance arrangements with the move to Creative Scotland
- Loss of income due to the London Olympics in 2012
- New Client Relationship Management System

This report reports on our findings in relation to these key issues.

2.5 Scope of the audit

Our audit work can be classified under the following three headings: governance, performance and finance. The main audit objective for each of these areas is summarised below.

2.5.1 Audit areas and audit objectives

Audit area	Audit objective
Governance	To review Scottish Screen's governance arrangements in relation to its national lottery fund, so far as they relate to: <ul style="list-style-type: none">• its review of its systems of internal control and risk management,• the prevention and detection of fraud and irregularity,• standards of conduct and prevention and detection of corruption.
Performance	To review Scottish Screen's arrangements for managing its performance and for securing economy, efficiency and effectiveness in its use of resources, in relation to its national lottery fund.
Finance	To provide an opinion on the truth and fairness of SSNLDF's financial statements and on the regularity of transactions. To review the SSNLDF's financial standing, and financial management arrangements.

This report sets out the results of our work in 2007/08. The action plan in section 6 details the recommendations we have made during the year. This report will be submitted to the Auditor General for Scotland and will be available on Audit Scotland's website, www.audit-scotland.gov.uk

3 Governance

3.1 Creative Scotland

The Scottish Government introduced the Creative Scotland Bill to the Scottish Parliament on 13 March 2008 and, if approved, the act would have led to the establishment of a new body, Creative Scotland, to replace Scottish Screen and the Scottish Arts Council.

The Bill fell at stage one of the parliamentary review process on 18 June 2008. This was principally due to uncertainty surrounding the financial arrangements in place for the creation of the new organisation. The Scottish Government plans to reintroduce the Bill to the Scottish Parliament. The previously anticipated establishment date for Creative Scotland was 1 April 2009 but this may now be delayed.

Scottish Screen has been working with the Scottish Arts Council and the Scottish Government towards the move to Creative Scotland and they have taken the following preparatory steps:

- Appointed a Joint Board on 1 February 2007. The Joint Board acts as the governing body of both Scottish Screen and the Scottish Arts Council.
- Established the Task Force (a sub-group of the Board) and the CEO Directorate (Scottish Screen's Chief Executive, Scottish Arts Council's Acting Chief Executive and the Transition Director) to deal specifically with the creation of Creative Scotland.
- Appointed a Transition Director.
- Mapped current activities, systems and processes.

Since the Bill fell on 18 June 2008, the Transition Team has continued its work towards the move to Creative Scotland, including the development of a Corporate Plan, ongoing work on the identification of costs of change and preparing a report on the costs and benefits of various options for going forward.

Scottish Screen was appointed as a lottery distributor by the National Lottery etc Act 1993 (as amended) and this responsibility will not automatically transfer to Creative Scotland, as a statutory instrument will be required. However, the Department for Culture, Media and Sport (DCMS) has provided details of future funding projections until 2012/13 and Scottish Screen is confident that responsibility for National Lottery funding will be transferred to the new body.

3.2 Statement on Internal Control

The framework of internal controls operating within Scottish Screen, as far as it relates to its national lottery distribution fund, is reported within the Statement on Internal Control (SIC) included with the annual accounts. No significant areas have been identified which require to be raised within the SIC.

We are satisfied that:

- the contents of the SIC are not inconsistent with information gathered during the course of our normal audit work, and
- the statement is in line with Scottish Ministers' guidance

3.3 Risk Management

Risk Management is important to the establishment and regular review of the system of internal control.

Scottish Screen has risk management arrangements in place. The risk register is used as a key management tool and is a standing item for discussion at management team meetings. The register includes those risks which could potentially result in the closure of Scottish Screen or its business, and those which may prevent it from achieving its strategic aims and objectives. Risks also include organisational change issues in respect of the transition to Creative Scotland.

3.4 Internal Audit

3.4.1 Review of internal audit service

Internal audit is a key component of Scottish Screen's corporate governance arrangements. Scottish Screen's internal audit service is provided by Wylie and Bisset, and the scope of their internal audit work includes the SSNLDF.

We carried out a review of the work undertaken by Wylie and Bisset to ensure it was sufficient in quality and volume and performed in accordance with accepted internal audit standards.

We concluded that Wylie and Bisset provides an effective internal audit service that complies with approved internal audit standards.

3.4.2 Co-ordination with internal audit

To avoid duplication of effort and ensure an efficient audit process, we have made use of internal audit work in the following areas:

- National Lottery funding and expenditure
- Creditors and accruals
- Project expenses
- IT systems
- Value for money – overhead expenses
- Corporate governance

We are grateful to Wylie and Bisset for their assistance during the course of our audit work.

3.5 Fraud and irregularity

We are required to consider the arrangements made by management for the prevention and detection of fraud and irregularity. Our audit identified no issues in relation to Scottish Screen's arrangement in regards to its national lottery fund.

3.6 Standards of conduct, integrity and openness

Propriety requires that public business is conducted with fairness and integrity. This includes avoiding personal gain from public business, being even-handed in the appointment of staff, letting contracts based on open competition and avoiding waste and extravagance. Guidance on standards of conduct, accountability and openness has been issued by the Scottish Government.

Our work in this area included a review of the Scottish Screen's arrangements, in so far as they relate to its lottery fund, against our standards of conduct checklist and a review of the registers of interest. We are pleased to report that our audit identified no issues of concern in relation to standards of conduct, integrity and openness.

3.7 Chief Executive's pay award

Scottish Screen, in common with other NDPBs, requires Scottish Government approval for pay awards for Chief Executives. The Scottish Government Pay Policy Unit has noted reservations in both 2006/07 and 2007/08 in relation to the measurability and assessment of the Chief Executive's performance. The Scottish Government Pay Policy Unit emphasised that bonuses should only be payable where "objectives have been exceeded" or where performance is "beyond that expected".

The Chief Executive's 2007/08 pay award and bonus had not been formally approved by the Scottish Government Pay Policy unit at the date of this report. However, both the Scottish Screen's Remuneration Committee and Scottish Government sponsoring department have supported the award. The award has been accrued within the 2007/08 financial statements for Scottish Screen but has not yet been paid. We recommend the Scottish Screen work with the Scottish Government Pay Policy Unit to prevent the situation reoccurring in 2008/09.

Action plan 6.3.2

4 Performance

4.1 Best Value

The Scottish Government defines Best Value as:

"[seeking to] secure continuous improvement in the performance of functions by public service organisations. Continuous improvement seeks to balance quality and cost considerations, and is achieved with regard to economy, efficiency, effectiveness, the equal opportunities arrangements, and sustainable development." ¹

Following the successful introduction of the Best Value regime to local government, Scottish Ministers introduced a non-statutory duty to deliver Best Value on all public sector accountable officers. Audit Scotland has been committed to developing the Best Value agenda across the public sector and is beginning to formalise this work in the central government sector.

Audit Scotland is developing a programme of audit toolkits which are to be used by appointed auditors across central government. Audit Scotland aims to develop seven toolkits initially to determine how efficiently and effectively central government bodies are using their resources within Best Value standards. These toolkits are to be rolled out as part of the external audit programme from 2007/08 onwards. The seven toolkits cover the areas of:

- Financial management;
- Efficiency;
- Information management;
- Procurement;
- Asset management;
- Performance management; and
- People management.

The Financial Management toolkit was the first toolkit to be rolled out by Audit Scotland in 2007/08. The toolkit states that effective financial management underpins service quality and improvement, is an essential element of good corporate governance, and provides a clear accountability basis for the stewardship of resources.

Best Values of Financial Management arrangements were performed at a number of central government bodies in 2007/08. We have not performed this review at SSNLDF due to the transition to Creative Scotland as well as the size of the organisation. However, we will review the results of the national study as part of our 2008/09 audit.

¹ <http://www.scotland.gov.uk/Topics/Government/PublicServiceReform/14838/564>

4.2 Corporate plan

Scottish Screen is currently guided by its Corporate and Operational Plan 2008/09 which was published in July 2008. The plan covers both Scottish Screen's grant-in-aid funded and lottery funded activities. The plan includes objectives set around the following primary themes: Education, Enterprise and Skills, Inward Investment and Communications, Market Development, and Talent and Creativity. The plan only covers a one year period in light of the timing of the creation of Creative Scotland.

4.3 Client Relationship Management system

SSNLDF continues with the development of the new Client Relationship Management (CRM) system. The system allows for robust monitoring of project performance and provides increased functionality to inform future decision making. Benefits have also arisen from additional functionality afforded by the system to support grant administration and management.

5 Finance

5.1 Annual accounts and audit timetable

We are pleased to report that we received draft annual accounts and working papers of an excellent standard in line with the agreed timetable.

The annual accounts are due to be approved by the Board on 28 August 2008 and are due to be submitted to the Scottish Government and the Auditor General for Scotland thereafter. The submission deadline with Scottish Government of 31 December 2008 will be met.

Scottish Ministers have issued guidance to Scottish Screen, through an Accounts Direction, which requires it to prepare separate annual accounts for its Lottery Fund. This Accounts Direction is attached as an appendix to the annual accounts. Scottish Screen is required to comply with the Accounts Direction and Financial Reporting Manual (FReM) when preparing these financial statements. The SSNLDF 2007/08 accounts comply with the requirements of the Accounts Direction and FReM in all material respects.

5.2 Unqualified audit opinion

Our audit opinions on the financial statements and the regularity of transactions are unqualified.

5.3 Financial performance and position

Table 1 – Key financial information

	2007/08 £000s	2006/07 £000s
National Lottery Fund proceeds	2,325	2,332
Other income	<u>294</u>	<u>527</u>
Total income	2,619	2,859
Awards commitments	3,720	2,749
De-commitment of previous awards	(1,194)	(581)
Other expenditure	<u>461</u>	<u>361</u>
Total expenditure	2,987	2,529
(Decrease) / increase in Fund	(368)	330
Balance held at NLDF	5,496	5,505
Net assets	3,035	3,403

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Scottish Screen planned to utilise some of its brought forward fund in 2007/08 and budgeted for a decrease in the fund of approximately £2 million. The actual decrease in the fund was a lot less due predominantly to a delay in the launch of some of the newly developed investment strands as well as a large number of de-commitments of previous awards due to the stringent review process.

5.4 Financial management

Scottish Screen has a responsibility to conduct its financial affairs in a proper manner. As part of our audit, we are required to consider Scottish Screen's arrangements, as they relate to the Lottery Fund, for financial planning, budgetary control and financial reporting. We have found no issues which require to be reported in this area.

Budgets are devised at the start of the year, approved by the Board, and are reviewed during the year to take account of new information. Management accounts are prepared to facilitate monitoring and review, and the cash position is also managed to ensure sufficient amounts are drawn down on a monthly basis to make award payments as they fall due.

5.5 Future plans

National Lottery receipts are projected to decrease because of funding being taken up by the London 2012 Olympic Games, both in terms of the direct transfer to the Olympic Distribution Fund commencing February 2009 and also through reduced non Olympic ticket sales. Management have identified and continue to consider the impact this will have on the Lottery Fund, and have a balance of funds built up with the National Lottery Distribution Fund (NLDF), to support activity for 2008/09. Future years income funding projections are issued by the NLDF and these are incorporated into the organisation's budget setting processes. Income projections, as set out by DCMS in March 2008, for the next 3 years are as follows:

	2008/09 £000s	2009/10 £000s	2010/11 £000s
Projected income from DCMS	2,342	2,179	2,165

Scottish Screen plans to fully utilise its brought forward funds to support expenditure in 2008/09. Detailed budgets for 2009/10 and beyond are dependent on developments with Creative Scotland.

On 2 July 2008, it was announced that SSNLDF would not be accepting any new applications for content production until 25 August 2008, with this date to be reviewed. This has happened previously, such as in March and April 2006 when it applied across all investment strands. However, that past moratorium period related to the revision of the SSNLDF investment guidelines, rather than being specifically related to level of commitments and related funding as is the case with this latest announcement.

5.6 Impact of Creative Scotland

5.6.1 Going concern basis

As highlighted above, Scottish Screen and the Scottish Arts Council will potentially be replaced by a new body – Creative Scotland. Financial Reporting Standard 18 – *Accounting Policies* (FRS 18) requires the Joint Board to assess whether there are any uncertainties about SSNLDF's ability to continue as a going concern and, if so, to disclose these uncertainties in the financial statements. The potential establishment of Creative Scotland and winding up of Scottish Screen has created uncertainty over the future of SSNLDF. This has been disclosed in the accounting policies in note 1 to the annual accounts. The directors consider the going concern basis to be appropriate as assets, liabilities and operations of the SSNLDF will be likely to transfer to the new body.

5.6.2 Transition costs

The cost of the transition work is shared between Scottish Arts Council and Scottish Screen, with the Scottish Arts Council taking the majority of the costs. The costs of the transition have not had any impact on the SSNLDF.

5.7 External delegation

Scottish Screen agreed to delegate £299,469 from its National Lottery Fund to Skillset Sector Skills Council in 2006/07 and a further £299,469 was delegated in 2007/08. This delegation is part of the Scottish Screen strategy to think and act in strategic partnership within the creative industries. The funding had not been fully spent during the period and as a result an agreement has been reached between the two parties to continue the funding for another year with a carried forward balance of £356,118.

For Scottish Screen to delegate externally they must meet conditions set out by Scottish Ministers. We reported in our previous annual report that all conditions had been met with the exception of a formal agreement in place. In the current year we confirmed that the agreement had been formalised. We did note however that the letter of agreement of the position at year end and the resultant carried forward balance was incorrect. This was corrected once we brought this to the attention of management. We have recommended that Scottish Screen reviews such agreements to ensure accuracy.

Action plan 6.2.1

5.8 Accounting and internal control systems

No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the Scottish Screen's ability to record, process,

summarise and report financial and other relevant data so as to result in a material misstatement in the accounts.

5.9 Audit adjustments

No material audit adjustments were made to the financial statements during the audit. A small number of presentational and disclosure changes were agreed, none of which impacted on the net movement in the fund.

5.10 International Financial Reporting Standards (IFRS)

The 2007 budget speech intimated the decision to adopt IFRSs for in public sector accounting by 2008/09. During the 2008 Budget speech the Chancellor postponed the implementation until 2009/10. Whilst this does not have an immediate impact on SSNLDF's annual accounts, the Board should be aware of this issue as it could have implications in the future.

6 Action Plan

Our annual report action plan details the control weaknesses and opportunities for improvement that we have identified during 2007/08. These are the issues that we believe need to be brought to the attention of the Joint Board.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

6.1 Priority rating

To assist the Joint Board in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. The rating structure is summarised as follows:

- Priority 1 High risk, material observations requiring immediate action.
- Priority 2 Medium risk, significant observations requiring reasonably urgent action.
- Priority 3 Low risk, minor observations which require management action.

6.2 Issues from our 2007/08 audit

Title	Issue Identified	Risk and Recommendation	Management Comments
<p>6.2.1</p> <p>External delegations</p>	<p>A signed agreement is in place governing the external delegation to Skillset. However, the balance carried forward within the initial agreement was incorrect. We brought this to the attention of management and this has since been rectified.</p>	<p>Scottish Screen should ensure that all agreements are reviewed for accuracy as at the particular date of signing.</p> <p>Priority 3</p>	<p>This was a human error and was addressed as soon as identified.</p> <p>Responsible officer: Head of Business Affairs</p> <p>Implementation date: Complete</p>

6.3 Follow-up of issues from the 2006/07 audit

Title	Original issue and recommendation	Original management response	Latest update position
<p>6.3.1</p> <p>Risk management approach</p>	<p>Scottish Screen has established risk management arrangements, however, there is no formal Risk Management Strategy document which has been approved by the Board and/or Audit Committee, which brings together all the elements of the risk management approach currently adopted by SSNLDF.</p> <p>The risk management process may not be approached in a manner which the Board and/or Audit Committee have explicitly deemed agreeable.</p> <p>We recommended that Scottish Screen should formally document a Risk Management Strategy and present this to the Audit Committee for approval.</p> <p>Priority 2</p>	<p>Scottish Screen has a comprehensive system of risk management that is well established and documented within SS's corporate documentation – extensive details of which are included with the Statement on Internal Control within the Lottery Financial Statements. Scottish Screen utilises a system for identification and management of risk which was reviewed at its establishment by the Board in December 2002, and in March 2003.</p> <p>The Risk Register is an item for review by the Audit Committee (regular review schedule for Management Team in place). Additionally an aim in moving towards CS is for the creation of a common format and approach for risk management for both SS and SAC.</p> <p>In light of this and the Board and Audit Committees adoption of the current system I do not see an identified risk or the added value of adoption of the recommendation at this stage.</p> <p>Responsible officer: CEO and COO</p>	<p>Recommendation was not implemented due to Management assessment of current provision as sufficient.</p> <p>No further action required</p>

Title	Original issue and recommendation	Original management response	Latest update position
<p>6.3.2</p> <p>Chief Executive Pay Award</p>	<p>In reviewing communications from the Scottish Executive regarding the Chief Executive's 5% pay award, we noted reservations in relation to the measurability and assessment of performance. Further, it was emphasised that bonuses should only be payable where "objectives have been exceeded" or where performance is "beyond that expected".</p> <p>We recommended that the criteria against which the Chief Executive's pay award will be measured should be robust, and follow "SMART" principles (Specific, Measurable, Achievable, Relevant and Time-bound), as far as is possible. The Remuneration Committee should make a clear and comprehensive assessment of whether the performance against the criteria merits a bonus.</p> <p>Priority 1</p>	<p>As the CEO, the exercise of following 'SMART' principles is more difficult, as the nature of the role demands the setting and achievement of objectives which are challenging and intrinsically more subjective in interpretation and measurement. A concern would be that in meeting the requirement to set 'SMART' objectives, that the aspiration of the objective is lessened. This is a consideration that the Remuneration Committee will need to reflect upon moving forward in ensuring the Scottish Minister's comments are addressed.</p> <p>It should be noted that Executive guidance was followed in the submission of the CEO pay award and that there have been ongoing discussions with our Sponsor Department and Pay Policy with regard to this matter.</p> <p>Responsible officer: Remuneration Committee</p>	<p>In 2007/08, the Remuneration Committee and the Sponsoring Department have approved the bonus but the Scottish Government Pay Policy Unit has yet to give its approval.</p> <p>Scottish Screen is continuing to pursue the Scottish Government to resolve this.</p> <p>We recommend that the Remuneration Committee and Scottish Screen work with the Scottish Government Pay Policy Unit to prevent a similar situation from occurring in 2008/09.</p> <p>Further action required</p>

Title	Original issue and recommendation	Original management response	Latest update position
<p>6.3.3</p> <p>External Delegations</p>	<p>The Financial Directions of Scottish Ministers sets out the rules around Scottish Screen National Lottery Distribution Fund delegating funds to external bodies. During 2006/07, the organisation delegated £299,469 to Skillset Sector Skills Council, with £89,375 being paid over during the year.</p> <p>Scottish Screen did not have the Framework Agreement signed by both parties at the date the transfer payment was made.</p> <p>We recommended that management ensure that all documentation is completed and signed off prior to payment of any monies to an external body, regardless of the extent to which a close and ongoing relationship exists in other aspects of operations.</p> <p>Priority 1</p>	<p>As communicated to the Auditors, this was an exceptional instance and not reflective of SS processes. All Directions of the Scottish Ministers were rigorously followed and at no time was a risk to SS's position identified.</p> <p>Although the Framework Agreement (FA) had not been signed at the time of the 1st payment, the extensive process of regulatory compliance, as required in the delegation of Lottery funds had been successfully completed, with the FA undergoing 15 revisions. All other agreements and documentation were complete at the time of payment – Letter of Intent issued from SS to Skillset; Notification of delegation issued to Scottish Executive and DCMS; SS appointed External audit and report completed; SS Accountable Officer (AO) letter issued to Skillset AO; Statement of assurance from Skillset AO to SS AO issued; and all of the following signed - 'Strategic Partnership Agreement, Secondment Agreement, Service Level Agreement; as well as a receipt of the signed trust payment letter.</p> <p>Responsible officer: CEO, COO, Head of Business Affairs</p> <p>Implementation date: Completed</p>	<p>We have confirmed that a formal agreement is in place which addresses the requirements of external delegation guidance. We have noted an issue in 2007/08, as reported above, regarding the year end position in current year.</p> <p>Action taken as agreed</p>



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