Key Issues Memorandum

Quality Meat Scotland

For the year ended 31 March 2011

Gary Devlin
Engagement Lead
T 0131 659 8554
E gary.j.devlin@uk.gt.com

Grace Scanlin
Audit Manager
T 0131 659 8526
E grace.scanlin@uk.gt.com

To the Management and Audit Committee of Quality Meat Scotland (QMS)

Grant Thornton UK LLP
1/4 Atholl Crescent
Edinburgh EH3 8LQ

T +44 (0)131 229 9181
F +44 (0)131 229 4560
DX ED428 Edinburgh
www.grant-thornton.co.uk

The purpose of this memorandum is to highlight the key issues affecting the results of the QMS and the preparation of the financial statements for the year ended 31 March 2011. It is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We take responsibility for this memorandum, which has been prepared on the basis of the limitations set out in 'The small print'.

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

Grant Thornton UK LLP

Contents

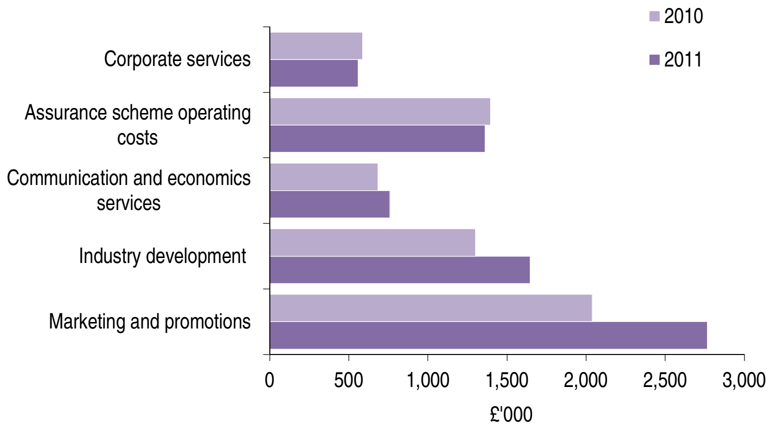
1 Executive summary

Financial Statements	
Audit Opinion	• We intend to give an unqualified opinion on both the financial statements of QMS for 2010-11 and on the regularity of transactions undertaken during the year.
Financial Statements	• The draft Financial Statements and supporting work papers were presented for audit on the 3 May 2011 and were of a high standard. This meant that only a small number of audit adjustments were proposed to the accounts.

Review of the Year	
Financial Performance	• QMS achieved a surplus in year of £92k, against a budgeted deficit position. This was achieved as a result of greater than anticipated levy income. However, we also noted that the organisation has managed to keep costs under control, notably within Corporate Services.
Organisational Effectiveness	• In line with our 2009-10 findings, we concluded that QMS is a well-run, and effective organisation. The self-effectiveness reviews carried out by the Board and Audit Committee have highlighted only minor areas for development. The organisation's approach to measuring and monitoring impact should ensure that performance continues to improve in future years.

2 Financial Statements

	2011 £	2010 £	2009 £
Net income /(expenditure)	71,229	(47,016)	(259,351)
Financing:			
Interest receivable	20,220	38,713	95,036
Exceptional item	0	100,000	0
Surplus / (deficit)	91,519	91,697	(164,315)



Statement of Income
QMS's total income increased by over £1.2m, to £7.2m in 2010-11, as the organisation benefited from the authorised increase in levy rates for Scottish meat producers. QMS reported a surplus on the Statement of Comprehensive Income of £91,519, despite budgeting for an in-year deficit. This was achieved following greater than anticipated levy income. This resulted in around £200k of additional income for QMS, which the Board elected to carry forward for activities in 2011-12, for which QMS currently estimate an in-year deficit of £300k.

Expenditure in 2010-11
As expected, in 2010-11, QMS expenditure rose substantially as a result of additional income achieved through the increase in levy charges. As a result, QMS was able to increase spend to support their strategic objectives relating to increasing sustainable economic growth in the Scottish red meat industry. The figure opposite highlights that the additional income was primarily invested in marketing and promoting Scotland's three red meat brands, Scotch Beef, Scotch Lamb and Specially Selected Pork. Expenditure increased from £2.04m in 2009-10, to £2.77m in 2010-11, an increase of 36%.

Investment in industry development has also increased to over 27% of QMS spend, at £1.6m (2009-10: £1.3m). QMS has a wide range of research projects underway throughout the year, including the IMEQ (Integrated Measurement of Eating Quality) project which aims to develop world-leading technology to assess the eating quality of red meat.

3 Key audit issues

3.1 Matters identified at the planning stage

In the conduct of our audit, we have not had to alter or change our audit plan, which we communicated to you in our Audit Approach Memorandum.

Our response to the matters identified at the planning stage are detailed below.

3.2 Accounting system and internal control

We have applied our risk methodology to your audit. This approach allows us to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

During our 2010-11 audit we observed the controls in place over the debtors and creditors cycles and found no issues with regards to internal control.

Status of audit

The draft Financial Statements and supporting work papers were presented for our audit on the 3 May 2011 and were of a high standard resulting in only a small number of adjustments being proposed.

Our audit is substantially complete although we are finalising our procedures in the following areas:

- Confirmation of the grant income for the FPMC grant in which some balances have been disputed by the Scottish Government, in order to ensure that the accrued income figure in relation to this grant is reasonable.

3.3 Matters identified at the planning stage

	Issue	Auditor response [and conclusion]
1	**Public Services Reform Act** Sections 31 and 31 of the Act impose new duties on the Scottish Government and listed public bodies to publish information on expenditure and on certain other matters as soon as is reasonably practicable after the end of each financial year. These sections came into force on 1 October 2010. Disclosure is required to cover the period from 1 October 2010 to 31 March 2011, but where information is readily available, then as a matter of good practice, the information for the whole financial year should be published. The one exception to this is that disclosure on number of individuals earning in excess of £150,000 per year is	We reviewed the arrangements in place at QMS for reporting under the Public Services Reform Act 2010 and found that while arrangements are in place for reporting under most of the Acts requirements, QMS are still in discussions surrounding the interpretation of some of the required disclosures. **Management response:** Implementation of the Act's requirements are continuing.

	Issue	Auditor response [and conclusion]
	required for the whole year. Disclosures are required in respect of: • total expenditure incurred on public relations, overseas travel, hospitality and entertainment, and external consultancy • payments made during the period with a value in excess of £25,000 • statement specifying the number of individuals who received remuneration in excess of £150,000 in the financial year • a statement of the steps taken during the financial year to promote and increase sustainable growth through the exercise of its functions • a statement of the steps taken during the financial year to improve efficiency, effectiveness and economy in the exercise of its functions. It is not necessary to include these disclosures in the annual accounts. Publication on the body's website would be sufficient but it is up to the individual body to decide on the most appropriate method.	
2	**Cost of Capital** The guidance contained in the 2010-11 FReM at paragraph 11.5.2 states that from 2010-11 onwards, bodies are no longer required to account for the cost of capital within their accounts. In accordance with IAS 8 Accounting policies, changes in accounting estimates and errors, this should be treated as a change an accounting policy. A prior year adjustment will therefore be required along with all necessary disclosures for transparency. The disclosures, in accordance with IAS 8, for a change in accounting policy are as follows: • the nature of the change • the reasons why applying the new accounting policy provides reliable and more relevant information • for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected • the amount of the adjustment relating to periods before those	Due to the immaterial amount of the 2009-10 cost of capital figure, we did not propose to adjust the prior year financial statements. **Management response:** Noted.

	Issue	Auditor response [and conclusion]
	presented, to the extent practicable if retrospective application is impracticable for a particular period, the reason why that is the case, and a description of how, and from when, the change has been applied.	
3	**Improving Public Sector Purchasing** In March 2006, the Scottish Executive published the Review of Public Procurement in Scotland by John McClelland. The report estimated that £740 million savings over the three years to 2008/09 could have been made if public bodies significantly improved how they purchased goods and service. In July 2009, Audit Scotland produced a report on the implementation of the Public Procurement Reform Programme, which the Scottish Executive launched in response to the McClelland Report. *Improving public sector purchasing* notes that there was no systematic basis for reporting procurement savings. There were also wide variations across public bodies in the quality of purchasing data and practice.	We found that arrangements for procurement are well-developed, although there is scope to use the Scottish Government's Procurement Journey website to ensure that practice remains up to date without amending policy documents. **Management response:** Noted. Procurement practice will be kept under review.

3.4 Matters identified during the course of the audit for Quality Meat Scotland

	Issue	Auditor response [and conclusion]
4	**Office 2010 upgrade** QMS have capitalised the costs incurred in upgrading their windows operating system in the year. Under IAS 16 subsequent expenditure on computer software is only capitalised if significant enhancement has been made to the asset. We would not consider this to be the case with regards to the Office 2010 upgrade.	We recommended treating the Office 2010 upgrade as expenditure through the profit and loss account. This is currently disclosed within unadjusted misstatements in Section 5.3. We also noted that the capital expenditure policy is to capitalise items of expenditure greater than £250. There may be scope to review this amount, although we recognise that QMS has relatively little capital spend. **Management response:** Noted. Threshold for capitalisation of items will be reviewed by management.
5	**Debtor Balances** We noted two large customers which have had debts outstanding for a period of five months which have not been provided for in the financial statements. More widely, we noted that QMS does not have a	Although a bad debt provision has not been necessary in prior years, QMS should ensure that the recoverability of debts is assessed at least annually.

	Issue	Auditor response [and conclusion]
	bad debt policy.	**Management response:** This is no longer an issue as two large debts at the year-end had been settled. Any issues surrounding debtors are brought to the attention of the Board. A bad debt policy would be developed.
6	**Cash and cash equivalents** From our testing of cash and cash equivalents we notes that amounts held in deposit accounts cannot be accessed by QMS for a fixed period of 12 months. These amounts should therefore be treated as a short term investment as per IAS 7.	We recommend that QMS reclassify the amounts held in the fixed term deposit accounts as short term investments. **Management response:** This has been reclassified.
7	**Grant Revenue** Our substantive testing of Grant revenue found that amounts released to the operating cost statement with regards to income which had previously been deferred was incorrect for one such grant.	We have proposed an adjustment for the amount identified. **Management response:** The proposed adjustment has been made.

4 Financial reporting matters

4.1 Review of key accounting policies

We have reviewed the financial statements and present our view of the key accounting policies below, bringing to your attention in particular any significant judgements and estimates.

Accounting area	Summary of policy	Comment
Revenue	• Statutory Red Meat Levy The value of statutory red meat levies recognised in the accounts of QMS is a combination of actual levy invoices raised for animals slaughtered within the period 1 April to 31 March and an estimate for any missing levy returns for the same period. • Grant Income Government grant income to QMS is for the delivery of specific programmes of work and is recognised in the period in which it becomes available • Customer Assurance Schemes Customer Assurance Scheme fees are based on inspection services provided in the year.	• The revenue recognition policy is deemed appropriate
Cost recognition	• QMS currently has no cost recognition policy in their accounts.	• QMS should consider whether a cost recognition policy is required.

Accounting area	Summary of policy	Comment
Asset Policy	• Depreciation is provided on all tangible fixed assets so as to write them off over their anticipated useful lives at the following rates: Computer Equipment – written off over 3 years Furniture, fittings and equipment – written off over 5 years All items of capital expenditure greater than £250 are treated as additions to tangible fixed assets.	• Depreciation policy deemed appropriate. • Refer to recommendation above relating to capital expenditure policy. There may be scope to capitalised only items which are more than £1000.
Stocks	• Quality Meat Scotland currently have no stock policy in their accounts.	• As QMS hold stock and accounting policy stating that stock is held at the lower of cost and net realisable value should be included.

4.2 Disclosure omissions

Our review found no omissions in the financial statements

5 Audit adjustments

5.1 Misstatements

Misstatements were identified by Grant Thornton and the following have also been adjusted for:

All adjusted misstatements are set out below.

The aggregate impact of unadjusted misstatements on the profit and loss account, were they to be processed, would result in a fall in profit by £7k.

5.2 Adjusted misstatements

		Operating Cost Statement		Balance sheet	
		Dr £000	Cr £000	Dr £000	Cr £000
Reclassification of fixed term deposit amounts from cash to short term investments	DR CR			750	750
Correction of deferred grant income	DR CR	13			13
Disclosure of Directors National Insurance Payments	DR CR	4 4			

5.3 Unadjusted misstatements

		Operating Cost Statement		Balance sheet	
		Dr £000	Cr £000	Dr £000	Cr £000
Adjustment to classify fixed asset addition as operating cost	DR CR	6			6

6 Governance and Performance

6.1 Introduction

All Accountable Officers are required to demonstrate economy, efficiency and effectiveness and the achievement of Best Value in the use of resources. QMS is accountable both to Scottish Ministers, but also to the levy payers who fund the organisation.

6.2 Achievement of Goals

We noted in our 2009-10 audit report that QMS is a well-run, highly effective organisation. QMS's review of 2010-11 highlights that the majority (92%) of actions with the annual business plan were achieved. During the year, QMS moved towards a more outcome-based approach to performance management. The Corporate and Business Plans were amended to adopt a range of outcome measures, and QMS is developing their approach to develop an impact assessment of all spend on industry activities. Arrangements are in place to ensure that funding is allocated to assess the effectiveness of each initiative as part of the project plan.

QMS has a well-developed approach to risk management to ensure that organisational goals remain on track. The risk register is approved annually by the Board, but is reviewed by the Senior Management Team and Audit Committee throughout the year. We noted that plans are in place to hold a risk management workshop for new Board members appointed from 1 April 2011. This will help to embed the culture of risk management across new and existing Board members.

6.3 Reviews of Effectiveness

During 2010-11, the organisation undertook reviews of the effectiveness of the Board, Audit Committee and Remuneration Committee, and noted minor areas for improvement. The Board has also completed Audit Scotland's Good Practice checklist on *Improving Public Sector Efficiency*. The aim of the checklist is to challenge and support public bodies in making efficiency improvements help public bodies move towards a better understanding of the relationship between costs, volume and quality of services to get improvements in productivity and reductions in cost. QMS's approach to corporate planning ensures that resources are allocated based on organisational priorities. Although there is not an efficiency policy in place, the Senior Management Team receive detailed monthly financial monitoring reports to identify any areas of concern. We also noted in year (Figure 2) that QMS continue to reduce the costs associated with Corporate Services, primarily as a result of efficiencies in staff deployment.

Figure 2: Corporate Services Costs

7 The small print

Purpose of memorandum

This Key Issues Memorandum has been prepared for the benefit of discussions between Grant Thornton, the **Management** of **Quality Meat Scotland** and the Board.

The purpose of this memorandum is to highlight the key issues affecting the organisations results and the preparation of the financial statements for the **year ended 31 March 2011**.

This document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the **QMS**.

This memorandum is strictly confidential and although it has been made available to management to facilitate discussions, it may not be taken as altering our responsibilities to the **QMS** arising under our audit engagement letter.

The contents of this memorandum should not be disclosed to third parties without our prior written consent.

Responsibilities of the directors and auditors

The Accountable Officer is responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the Accountable Officer confirms that our understanding of all the matters in this memorandum is appropriate, having regard to their knowledge of the particular circumstances.

Clarification of roles and responsibilities with respect to internal controls

The Accountable Officer is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to the Board that he has done so.

The Board is required to review the body'ss internal financial controls. In addition, the Board is required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Board should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by internal audit or ourselves.

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We would be pleased to discuss any further work in this regard with management.

In accordance with best practice, we analyse our fees below:

	£
Audit	10,000

Independence and robustness

To maintain our independence as auditors we ensure that Grant Thornton, its partners and the audit team have no family, financial, employment, investment or business relationship with Quality Meat Scotland. Our fees paid by Quality Meat Scotland do not represent an inappropriate proportion of total fee income for either the firm, office or individual partner.

At all times during the audit, we will maintain a robustly independent position in respect of key judgement areas.

Audit and non-audit services

We have not supplied any non audit services to QMS in the year 2010-11.

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- the form of reports expected