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Quality Meat Scotland

Annual Report to the Audit Committee and the Auditor General for Scotland - FINAL

Year ended 31 March 2012

pwc

Audit Committee
Quality Meat Scotland,
Rural Centre,
West Mains, Ingliston,
Newbridge
EH28 8NZ

27 June 2012

Dear Sirs

We are pleased to provide you with our Annual Report to the Audit Committee and the Auditor General for Scotland, on the results of our external audit of Quality Meat Scotland for the year ended 31 March 2012. The main purpose of the report is to communicate the more significant matters arising from our external audit of the financial statements that we believe are relevant to those charged with governance.

We have completed our external audit work and have issued an unqualified audit opinion on the financial statements for the year ended 31 March 2012 on 13 June 2012.

Once again we offer thanks to Management and staff for their assistance with our external audit work. .

Yours faithfully

PricewaterhouseCoopers LLP

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The matters raised in this and other reports that flow from the audit are only those which have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all matters arising and in particular we cannot be held responsible for reporting all risks in your business. This report has been prepared for and only for *Quality Meat Scotland* in accordance with the terms of our engagement letter and for no other purpose. We do not accept or assume any liability or duty of care for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

1 Introduction

We have pleasure in presenting this report relating to our audit of the financial statements of Quality Meat Scotland for the year ended 31 March 2012.

We have discussed this report with the Chief Executive and Corporate Services Manager as part of our audit process. The purpose of this report is to update the Committee on the progress of the audit and of any significant matters that have arisen during the course of our work.

1.1 Audit status

Our audit work on the draft financial statements for the year ended 31 March 2012 was carried out over a one week period commencing 07 May 2012. The audit is complete, subject to the following outstanding matters:

- the production of a final set of financial statements incorporating the proposed financial and disclosure adjustments arising from our audit work;
- approval of the financial statements and letter of representation; and
- completion procedures, including subsequent events review.

1.2 Audit overview and conclusions

Subject to the satisfactory resolution of the matters set out above, finalisation of the financial statements and their approval by the Audit Committee, we expect to issue an unqualified audit opinion for Quality Meat Scotland.

1.3 Findings arising from the audit

Section 2 of this report summarises the findings arising from our audit.

1.4 Misstatements and significant deficiencies in internal control

A summary of corrected and uncorrected misstatements is included in Appendix 1. A summary of control deficiencies identified is included in Appendix 2.

1.5 Other areas of feedback

Section 3 contains other matters for the attention of those charged with governance, including elements of communication required under International Standard on Auditing (ISA) 260 (revised and re-drafted) "Communication with those charged with governance".

We look forward to the opportunity to discuss the points raised in the report with you at the Audit Committee meeting on 13 June 2012.

We would also like to take this opportunity to express our thanks for the co-operation and assistance we have received from the management and staff of Quality Meat Scotland throughout our work.

2 Audit Findings

Our understanding of the organisation developed further in the course of our planning and interim audit work, to the extent that it was necessary to adjust our Audit Plan for the year, as initially presented to the Audit Committee on 14 March 2012. The updated plan identified the following significant audit risks:

Areas of audit risk	Audit approach
Revenue recognition	
There is a rebuttable presumption within our audit methodology that there is a risk of material misstatement due to fraud relating to revenue recognition. In view of the fact that the organisation does not receive Grant-in-Aid income from the Scottish Government and its revenue base is therefore less stable and predictable than for other Non-Departmental Public Bodies (NDPBs), we do not intend to rebut the presumption.	We will review the current treatment of income to ensure that it is in accordance with the requirements of accounting standards, focusing on higher risk areas such as accrued income and credit notes. Our cut-off testing will be planned to ensure that there is no overstatement of income in the financial year.
Consideration of fraud risk	
All organisations are at risk of fraud, with specific fraud risks being: • the potential for intentional misstatement of the financial statements • the misappropriation of assets; and • management override of controls.	We will review management's overall fraud arrangements and fraud policies such as whistle blowing policies. Our assessment of controls will consider their effectiveness for preventing and identifying fraud, with any weaknesses highlighted to management. We will perform audit testing of journals to ensure their legitimacy, and will incorporate unpredictability into our testing of income and expenditure.
Management of surplus cash	
A large surplus cash balance is maintained by the organisation in order to help ensure its status as a going concern in the event of a sharp, temporary downturn in the fortunes of the Scottish red meat industry. There is considered to be a heightened and specific risk of fraud where large balances are maintained by organisations with no dedicated treasury function within the finance team.	We will review management's arrangements for the reconciliation of bank and depository balances with the general ledger, and the ongoing monitoring and review of the organisation's cash balances.

We had initially intended to focus upon the recognition of operating expenditure as a significant risk. Based on planning and interim work in March 2012 it was then thought more aligned with QMS activities to concentrate on revenue recognition as a significant risk in view of the fact that regularity in expenditure is perhaps less of a concern than for NDPBs which are in receipt of Grant-in-Aid funding from the Scottish Government.

We have included a summary of our findings below.

Our response to the areas of audit focus identified in the audit plan:

Risk identified/area of audit focus	Audit response
Revenue recognition **Significant risk**	We examined and tested the process through which management has identified and quantified any income that needs to be accrued (or deferred) at year-end. We also performed substantive testing on a sample of transactions relating to income from the Consumer Assurance schemes and grant income. We can confirm that our work in this area did not identify any errors that required adjustment to the financial statements.
Consideration of fraud risk **Significant risk**	In accordance with our audit plan, we reviewed significant journals and examined management's accounting estimates for bias. We can confirm that our work in this area did not identify any errors that required adjustment to the financial statements.
Management of surplus cash **Significant risk**	We examined and tested the processes through which management manages the organisation's cash, specifically testing the monthly bank reconciliation process and evaluating the use of management information in decision-making around the short-term investment of surplus cash. We can confirm that our work in this area did not identify any errors that required adjustment to the financial statements.

3 Communications required under ISA 260

The following table contains communication required under ISA 260 (revised and re-drafted) "Communication with those charged with governance".

Requirement	Delivery of requirement
Uncorrected and corrected misstatements	We identified two misstatements, one corrected and one uncorrected, that we believe should be brought to your attention. Details of these can be found in Appendix 1.
Significant accounting principles and policies	Significant accounting principles and policies are disclosed in the notes to the financial statements. We have asked board members to represent to us that they have considered the accounting policies and that here have not been any material changes in the accounting principles and policies used during the year.
Significant qualitative aspects of the organisation's accounting practices and financial reporting , management's judgments and accounting estimates	No significant judgments or accounting estimates were required in the preparation of the financial statements.
Deficiencies in the internal control environment	The purpose of the audit was to express an opinion on the financial statements. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that were appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters being reported are limited to those deficiencies that we have identified during the audit and that we have concluded are of sufficient importance to merit being reported to you. Such deficiencies in internal controls are included in Appendix 2.
Details of material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern	We have not encountered any material uncertainties which cast doubt upon the ability of Quality Meat Scotland to continue as a going concern.
Disagreements with management	We have not disagreed with management on any matters which, individually or in aggregate, could be significant to the financial statements.
Confirmation of audit independence	We confirm that, in our professional judgment, as at the date of this document, we are independent auditors with respect to the entity and its related entities, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit engagement leader and the audit staff is not impaired.

Governance and Performance

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.

QMS has a well-developed approach to risk management to ensure that organisational goals remain on track. This process has continued to be refined on an ongoing basis with this being considered regaurly by the Board and Audit Committee.

Appendices

Appendix 1 – Summary of corrected and uncorrected misstatements

The tables below set out details of the corrected and uncorrected misstatements identified in the course of our substantive year-end audit work.

Corrected misstatements

No	Description of misstatement	Operating Cost Statement		Statement of Financial Position	
		Dr	Cr	Dr	Cr
1	Dr Other Operating Costs Cr Trade Payables and Other Current Liabilities (Accruals) *Being an adjustment to accrue for item of expenditure incurred in November 2011 not invoiced until April 2012.*	£8,254			£8,254
Total corrected misstatements		**£8,254**			**£8,254**

Uncorrected misstatements

No	Description of misstatement	Operating Cost Statement		Statement of Financial Position	
		Dr	Cr	Dr	Cr
2	Dr Trade Payables and Other Current Liabilities (Accruals) Cr Other Operating Costs *Being an adjustment to reduce over-accrual in respect of purchase order relating to design and delivery of leaflets. Per budget holder, design services provided in 2011/12, but leaflets not delivered as at year end – as expense not incurred on production and delivery until 2012/13, accrual should be reduced accordingly.*		£2,011	£2,011	
Total uncorrected misstatements			**£2,011**	**£2,011**	

Appendix 2 – Deficiencies in internal control

Current year recommendations

The following points detail our internal control recommendations based on the results of our current year audit. We have graded our recommendations according to their possible impact.

(H)	High	Serious matters which should be addressed as a matter of urgency
(M)	Medium	Areas where attention is required
(L)	Low	Best practice recommendations

Completion of monthly bank reconciliations – Low

Finding	Recommendation
In the course of our review of the preparation and review of five monthly bank reconciliations at our interim audit visit, we noted one instance whereby a reconciliation had not been completed – this was for the month of October 2011. Upon discussion with management, it emerged that a bank error had occurred in October 2011 whereby a sum in the order of £7,000 was taken from an account in error and not replaced for some weeks. The error was acknowledged by the bank and rectified in the month of November, following which a reconciliation was prepared and reviewed for all bank accounts as at the month end. The reconciliation exercise for October was not completed for any of the bank accounts, despite the fact that the error only related to one account.	Due to the significant sums of cash held by the organisation, we consider that the monthly bank reconciliation exercise represents a key control in ensuring that cash balances are effectively monitored and errors are identified on a timely basis. In the case of the issue that arose in October, it would have been best practice to complete the bank reconciliation exercise as normal, capturing the bank error as a reconciling item on the face of the reconciliation. This would have ensured that the accounts unaffected by the error would still have been reconciled adequately for October. Where similar circumstances arise in future, all bank accounts should be reconciled each month, regardless of bank errors or any other factors which might arise.

Management response

Bank reconciliations are carried out as part of the Monthly Management Accounts preparation procedures. This was a one-off incident however the recommendation made has been noted and will be implemented should a similar circumstance arise in future.

Creation of account codes for inventory and provision for doubtful debts – Low

Finding	Recommendation
The current chart of accounts currently has no separate account codes in place for the posting of the stock and provision for doubtful debt balances. In the course of our final audit fieldwork, we found that the year end stock balance (£5,566, held at cost) and the provision for doubtful debt (£2,352) had both been posted to the prepayments account code. While both balances were considered immaterial to this year's financial statements and have both been disclosed appropriately therein, it would be appropriate for these items to be posted to their own, distinctive account codes – this would further improve the understandability of working papers provided for audit purposes.	In the event that either of the balances noted should prove significant or material in future, they should have their own account codes as a matter of best practice. New account codes should be created within the chart of accounts for both inventory and provision for doubtful debt balances, and the balances noted at the balance sheet date should be transferred to them from the prepayments account code via manual journal.

Management response

Recommendation has been actioned.

Location of server hardware – Low

Finding	Recommendation
In the course of our work on IT General Controls during our interim audit visit, we noted that the server running the key financial applications was readily accessible to members of staff due to its location nearby common printing and copying facilities, adjacent to the main office space. Although housed in a small, lockable rack, the key was found to be in the open rack door upon inspection. Relative ease of access to the server hardware, and its placement in a commonly-used location of the office, increases the likelihood of accidental damage to the hardware and, in turn, exposure to a data loss incident. It should be noted that a mitigating control was found to be in place with regards to data loss, in that daily backups are completed and held off-site in order to facilitate prompt restoration, where required.	We appreciate that, due to the size of the organisation's premises, it might be difficult to find a better, alternative location than that currently in use. However, some consideration should be given to this – one of the management offices, for example, would prove to be a more secure location if the space was available and movement of the equipment was not cost-prohibitive.

Management response

The location of the server within the QMS office was raised during the ICT Health Check Internal Audit carried out in 2008. At that time it was noted that it was not possible to relocate the server hardware in a separate secure location as none existed. This area of internal audit is being re-visited later this year when we will again review the practicalities of relocating the servers. In the meantime the lockable rack and will be kept securely locked.

Review process for manual journal postings – Low

Finding	Recommendation
In the course of our manual journals testing, we noted that Finance Manager currently has responsibility for the review of manual journal postings, despite being the individual undertaking the most posting activity in his management accounting role. Furthermore, all postings are recorded manually, in hard copy, in a folder which is to be reviewed by the Finance Manager each month. In the case of eight manual journals tested, we found no evidence of review (as indicated by date and signature on the hard copy record of the journal). In any case, the self-review element of the design of the control is considered to constitute a control weakness.	We would recommend that the Corporate Services Manager take on responsibility for the review of manual journal postings, incorporating monthly reconciliation of the entries recorded in the hard copy folder to a system-generated report, in order to ensure completeness of the hard copy record.

Management response

Recommendation noted for action. The Corporate Services Manager will review manual journal postings during the Monthly Management Accounts preparation procedures.

Signing and authorisation of significant contracts – Low

Finding	Recommendation
In the course of testing significant contracts from the client's schedule of contracts during our interim audit visit, we identified one instance whereby a contract had been signed by a Senior Manager within the organisation in excess of his delegated authority limit. The contract committed the organisation to expenditure in the order of £110k for the 2011/12 financial year. Per the organisation's own procedures the Chief Executive, Uel Morton, must sign any contracts which cause the organisation to incur a commitment of a value in excess of £25k.	The Chief Executive should re-iterate the importance of this control to Senior Managers handling contracts on behalf of the organisation, and consider incorporating the name of the officer who has signed a given contract into the schedule of contracts, in order that compliance can be monitored as new contracts are entered into.

Management response

Chief Executive emailed Senior Managers on 22 May 2012 re-iterating the importance of this control and reconfirming the delegated authority limits for signing contracts. The Schedule of Contracts will be updated in June to include a column confirming the name of the QMS representative who has signed the contract in order to monitor compliance.