www.pwc.co.uk

# *Quality Meat Scotland*

## Annual report to Those Charged with Governance and the Auditor General for Scotland

For Audit Committee discussion

Year ended 31 March 2015

June 2015

PricewaterhouseCoopers
Atria One
144 Morrison Street
Edinburgh
EH3 8EX

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

10 June 2015

Ladies and Gentleman,

We are pleased to enclose our report to the Audit Committee in respect of our audit for the year ended 31 March 2015. The primary purpose of this report is to communicate the significant findings arising from our audit that we believe are relevant to those charged with governance.

The scope and proposed focus of our audit work was summarised in our audit plan, which we presented to the Audit Committee in October 2014. We have subsequently reviewed our audit plan and concluded that our original risk assessment remains appropriate. The procedures we have performed in response to our assessment of significant audit risks are detailed in Section 2.

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion on the financial statements on 10 June 2015. At the time of writing, the key outstanding matters, where our work has commenced but is not yet finalised, are:

- Receipt of management representation letter; and
- Approval and signing of accounts.

We will provide an oral update on these matters at the meeting on 10 June 2015 and we look forward to discussing our report with you on this date. Attending the meeting from PwC will be Martin Pitt.

Yours faithfully

PricewaterhouseCoopers LLP

# Contents

# Section 1. Executive summary

## Introduction

We set out in this report our significant findings from our audit of Quality Meat Scotland ("the Body") for 2014/15, together with those matters which auditing standards require us to report to you as "those charged with governance" of the Body.

We carried out our audit work in line with our 2014/15 audit plan that we presented to you in October 2014. Our audit is not designed to identify all matters that may be relevant to you. Accordingly, the audit does not identify all such matters. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

## Framework for Our Audit

Our audit is conducted in accordance with Auditing Standards (International Standards on Auditing ('ISAs') (UK and Ireland)) and the Code of Audit Practice ('the Code').

The Code explains how external auditors should carry out their functions under the Public Finance and Accountability (Scotland) Act 2000. The audit of financial statements is covered by engagement and ethical standards issued by the UK Auditing Practices Board (APB), so the Code focuses more on the wider functions of public sector auditors. We have conducted our audit in accordance with the relevant requirements of the Code.

## Respective Responsibilities of Management and Auditors

### *Management*

It is the responsibility of the Body's management to prepare the financial statements in accordance with statutory and other relevant requirements. This means:

- acting within the law and ensuring the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements timeously which give a true and fair view of the financial position of the Body and its expenditure and income for the year ended 31 March 2015; and
- preparing a Directors' Report, a Strategic Report, a Governance Statement and a Remuneration Report.

### *Auditors' responsibilities*

Our responsibilities are to provide you with an audit report stating whether, in our opinion the financial statements and the part of the Remuneration Report to be audited and give an opinion on:

- whether they give a true and fair view of the financial position of the Body and its expenditure and income for the year;
- whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements;
- whether the information which comprises the annual report included with the financial statements is consistent with the financial statements; and
- whether expenditure and receipts have been incurred and applied in accordance with guidance from Scottish Ministers (the regularity opinion).

We are also required to review and report as necessary on other information published with the financial statements, including the directors' report, governance statement and the remuneration report.

# Financial Statements

As a result of our work, we proposed a number of disclosure audit adjustments to the draft financial statements. We note that there were two misstatements identified during the audit process resulting in a net debit of circa £16,000 to the Income Statement. All identified misstatements were corrected by management therefore no uncorrected misstatements remain in the final financial statements.

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion on 10 June 2015.

# Financial performance

The Body's key financial performance for the period is as follows:

- An operating surplus of £0.28m as at 31 March 2015, compared with an operating surplus of £0.06m as at 31 March 2014 with the increase in the year being largely attributed to a reduction in marketing and promotion expenditure of £0.59m and a reduction in industry development expenditure of £0.18m offset by a decrease in other income of £0.47m during 2014/15. Decreases are mainly due to general decreases in Scottish Government grant funding as well as the Brand Strengthening grant having nearly been fully utilised and therefore less associated income and expenditure in relation to this area in the year.
- An overall surplus of £0.30m as at 31 March 2015, compared with an overall surplus of £0.08 as at 31 March 2014.
- Net assets of £1.61m as at 31 March 2015, compared with net assets of £1.31m as at 31 March 2014.

Please note that copies of this report will be sent to the Audit Scotland in accordance with their requirements.

We thank the management and staff of the Body for their co-operation and assistance during the course of our work.

# Section 2: Significant audit and accounting matters

We have set out in this section the significant matters arising from our audit.

## Matters identified in our audit plan

Set out below is a summary of our response to matters identified in our audit plan:

| Matter arising | Audit response |
|---|---|
| ***Fraud and management override of controls***<br>ISA (UK&I) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit.<br><br>This includes consideration of the risk that management may override controls in order to manipulate the financial statements. | • We tested high risk manual journals and identified the business rationale for these transactions;<br>• We examined management's accounting estimates for bias and performed detailed testing over bad debt provision, accrued income, accruals and deferred income; and<br>• We performed unpredictability testing over a sample of immaterial receipts received at for one week pre year end and one week post year end in 2014/15 to ensure that income was complete and had been recorded in the correct period by the Body.<br><br>Our work did not identify any material errors that required adjustment to the financial statements. |
| ***Recognition of income***<br>Under ISA (UK&I) 240 there is a (rebuttable) presumption that there are risks of fraud in revenue recognition. There is a risk that the Body could adopt accounting policies or treat income transactions in such a way as to lead to material misstatement in the reported revenue position. | • We evaluated and tested the accounting policy for income recognition to ensure that it is consistent with the requirements of the International Financial Reporting Standards (IFRSs), as adopted by the European Union, and as interpreted and adapted by the 2014/15 Government Financial Reporting Manual (FReM);<br>• We performed substantive analytical procedures over statutory red meat levy income to gain assurance that the income for 2014/15 was recorded at the correct value and recognised in the correct accounting period;<br>• We performed substantive testing on a sample of transactions from consumer assurance scheme fees income and other income and confirmed with reference to supporting documentation that each was recorded at the correct value, in the correct accounting period and was posted correctly within the accounts;<br>• We identified high risk manual journals posted to revenue accounts and identified the rationale for these transactions; and<br>• We reviewed estimates for revenue, accrued income for example, to ensure that it was accounted for on an accurate basis and in the proper period.<br><br>We did not identify any issues to report to you as a result of our work. |

# *Materiality*

We have conducted our work in accordance with the materiality levels detailed below. We have applied a de minimis level of £6,700. This is the level above which all uncorrected misstatements are reported to the Audit Committee.

We note that our final overall materiality calculated below at £135,700 has reduced from the amount of £140,000 communicated in our Audit Plan presented to the Audit Committee in October 2014. The reduction in the overall materiality of £4,300 is simply due to our final calculation being based on the year end financial statements as opposed to our earlier calculation in October 2014 which was based on budgeted income for the year. The change is deemed minimal and has not impacted our planned audit approach in any way.

| | £ |
|---|---|
| **Overall materiality** – This is the amount we have applied in assessing the overall impact on the group financial statements of potential adjustments | 135,700 |
| **Performance materiality -** We have applied this to direct the amount of work performed over each financial statement line item – for example in calculating sample sizes | 101,800 |
| **De minimis posting level -** Under ISA (UK & I) 450, we are required to report to the Audit Committee on all unadjusted misstatements in excess of a 'de-minimis' or 'clearly trifling' amount | 6,700 |

# Misstatements and significant audit adjustments

There are no uncorrected misstatements arising from our audit to report to you.

# Action Plan

We can confirm that we did not identify any significant deficiencies in internal control as part of our audit procedures. We therefore have no recommendations we wish to make in respect of the Body and as such no Action Plan has been included within this report.

# Qualitative aspects of accounting practices

## *Financial statement disclosures*

We have also reviewed, and tested, the material disclosures in the financial statements. We identified no significant issues as part of this work.

## *Governance Statement*

The Financial Reporting Manual requires Chief Executives to sign a Governance Statement which covers all controls including financial, operational, compliance and the management of risk.

We reviewed the governance statement and based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

# Accounting matters

## *Related parties*

In forming an opinion on the financial statements, we are required to evaluate:

- whether identified related party relationships and transactions have been appropriately accounted for and disclosed; and

- whether the effects of the related party relationships and transactions cause the financial statements to be misleading.

It is a requirement of International Accounting Standard 24 that transactions with related parties are identified and disclosed in the financial statements. In the context of the Body, related parties would include Directors and Senior Management and their close family members. Related party transactions are identified and declared by Directors and Senior Management and will either relate directly to that individual or will be an interest of that individual's close family member. Failure to capture this information may result in an incomplete listing of related parties being disclosed to the audit team and an incomplete listing of related party transactions being disclosed in the financial statements.

The audit team requested that Related Party declaration forms were circulated to and completed by all Directors and Senior Management for the year ended 31 March 2015. The audit team was able to review responses from all Directors and Senior Management from whom we had requested details of their related parties as part of our audit procedures.

In addition, we performed audit procedures to confirm that related party declarations were complete and that the related party disclosure within the accounts was complete. During this testing we identified that the Scottish Food Quality Certification (SFQC) and the Scottish Agricultural Organisation Society Limited are considered to be related parties of QMS and as a result expenditure of £1.3m and £0.3m relating to these related parties respectively should be disclosed within the Related Party Transactions note in the annual accounts. Management agreed with PwC's findings and have updated the disclosures within the annual accounts accordingly.

We are satisfied that the related party listing provided by the Body to the audit team is complete and that the related party transaction disclosure within the financial statements is now complete.

## *Going Concern*

The Body has prepared budgets for 2015/16 and 2016/17 as part of their Corporate Plan. We note the following key points:

| **Balance** | **2014/15 Actual £'000** | **2015/16 Budget £'000** | **2016/17 Budget £'000** |
|---|---|---|---|
| **Income** | 6,783 | 6,335 | 5,794 |
| **Expenditure** | (6,485) | (6,585) | (5,794) |
| Net surplus/(deficit) | **298** | **(250)** | - |

Budgets are based on various assumptions including QMS having assumed no increase in levy rates and having only included budgeted grant income and expenditure for grants applied for and awarded.

We have reviewed management's budgets and the assumptions used within and deem these to be reasonable.

We note that the Body is budgeting a deficit in 2015/16 and a breakeven position as at the end of 2016/17. We note that as at 31 March 2015 the Body has a cash balance of circa £1,207,000 (2013/14 – circa £931,000) and that the Body is in a net current assets position at 31 March 2015 of circa £1,594,000 and was also in a net current assets position in the prior year as well (2013/14 – circa £1,300,000). We are therefore satisfied that the adoption of the going concern assumption in the preparation of the Body's financial statements remains appropriate.

# Section 3. Governance and internal control

## Governance structure

We have assessed the Body's overall governance arrangements including a review of Board and key Committee structures and minutes, financial reporting to the Board, and risk management. Appropriate evidence of activity has been provided by the Body.

The Code of Audit Practice requires us to review and report on the Body's Annual Governance Statement. The Body has used the appropriate format for its Statement and has outlined the processes it had employed to identify and evaluate risks. In addition, key elements of the Body's control framework have been highlighted.

We consider that the governance arrangements in place are appropriate.

## System of internal control

The Chief Executive Officer in conjunction with management and the Audit Committee is responsible for developing and implementing systems of internal financial control and having in place proper arrangements to monitor their adequacy and effectiveness in practice.

We review these arrangements for the purposes of our audit of the financial statements and for our review of the annual governance statement and report to you any significant deficiencies in internal control that we find during our audit.

We have no significant matters to bring to your attention in relation to the system of internal control.

## Risk management

Responsibilities for the risk management process lies with the Board, which is provided with information and guidance by the Audit Committee and the senior executive team.

Reports on the management of risk are standing agenda items at meetings of the Board, the QMS executive team and the Audit Committee. The risk register is reviewed regularly by the Audit Committee at their meetings.

## Internal Audit

The role of internal audit is determined by management and therefore its objectives differ from ours. Part of our overall audit approach involves gaining an understanding of the internal audit function to determine if it would be effective and efficient to use their work.

During 2014/15, the Body continued to have an outsourced internal audit function provided by Chiene & Tait. We have reviewed the internal audits performed during the financial year, which included reviews on the Body's HR Policies and Procedures Review, Income Streams and Corporate Credit Card and Staff Expenses. As in prior years, we have taken no reliance on the work performed by internal audit. We have used the work of internal audit to gain an understanding of the Body as relevant for our external audit planning procedures.

Based on audit work performed we consider the internal audit function within QMS to be appropriate for the requirements of the Body.

# Section 4. Fraud

International Standards on Auditing (UK&I) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors and management are summarised below:

## Auditors' responsibility

Our objectives are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
- to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- to respond appropriately to fraud or suspected fraud identified during the audit.

## Management's responsibility

Management's responsibilities in relation to fraud are:

- to design and implement programmes and controls to prevent, deter and detect fraud;
- to ensure that the entity's culture and environment promote ethical behaviour; and
- to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalisation.

Management have confirmed that they are not aware of any actual or suspected significant frauds having occurred during 2014/15. We confirm that we have not identified any actual or suspected significant frauds as part of our audit procedures.

# Section 5. Independence

## Independence and objectivity

We have made enquiries of all PricewaterhouseCoopers' teams providing services to you and of those responsible in the UK Firm for compliance matters.

There are no matters which we perceive may impact our independence and objectivity of the audit team.

## Independence conclusion

At the date of this report we confirm that in our professional judgement, we are independent accountants with respect to the Body, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit team is not impaired.