

## Key Issues Memorandum

Quality Meat Scotland

For the year ended 31 March 2010

FINAL

Gary Devlin  
Engagement Lead  
T 0131 6598554  
E [gary.j.devlin@gtuk.com](mailto:gary.j.devlin@gtuk.com)

Kirsten Tasker  
Audit Manager  
T 0131 6598546  
E [kirsten.tasker@gtuk.com](mailto:kirsten.tasker@gtuk.com)



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

The purpose of this memorandum is to highlight the key issues affecting the results of QMS and the preparation of the financial statements for the year ended 31 March 2010. 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' (Section 6).

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

**Grant Thornton UK LLP**  
¼ 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](http://www.grant-thornton.co.uk)

**Chartered Accountants**

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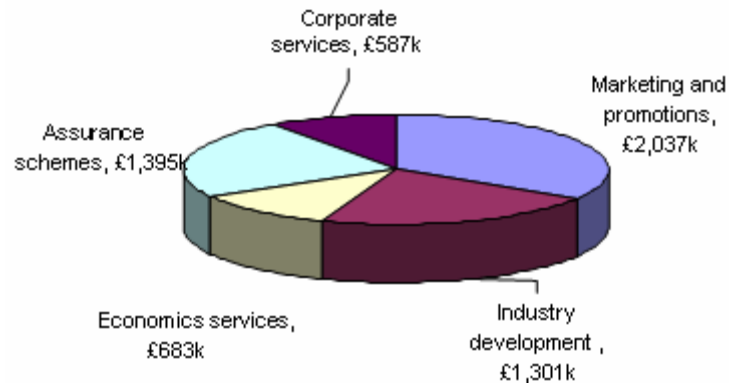
# 1 Executive Summary

<b>Financial Statements</b>	
Audit Opinion	<ul style="list-style-type: none"> <li>We intend to give an unqualified opinion on both the financial statements of QMS for 2009-10 and on the regularity of transactions undertaken during the financial year.</li> </ul>
Financial Statements	<ul style="list-style-type: none"> <li>The draft Financial Statements and supporting working papers were presented for audit on the 3 May 2010 and were of a high standard. This meant that no audit adjustments were required to be made to the accounts.</li> </ul>
IFRS Conversion	<ul style="list-style-type: none"> <li>We carried out a comprehensive review of the draft 2009-10 IFRS accounts against the requirements of the 2009-10 FReM. The annual accounts submitted for audit are IFRS compliant.</li> </ul>
<b>Governance issues</b>	
Annual Review of Performance	<ul style="list-style-type: none"> <li>QMS' governance arrangements are good and operating effectively. The Board and Audit Committee review their performance and effectiveness annually, in line with good practice guidance.</li> </ul>
Budget Monitoring	<ul style="list-style-type: none"> <li>We concluded that budget monitoring arrangements are robust.</li> </ul>
<b>Performance issues</b>	
Best Value	<ul style="list-style-type: none"> <li>QMS are a high performing organisation and can demonstrate Best Value in its activities.</li> </ul>

## 2 Financial Reporting

### 2.1 Financial Statements

	2010 £	2009 £
<b>Operating deficit</b>	(47,016)	(259,351)
<b>Financing:</b>		
Interest receivable	38,713	95,036
Exceptional item	100,000	0
<b>Surplus / (deficit)</b>	91,697	(164,315)



### Operating Cost Statement

QMS reported an operating deficit on its operating cost statement of £47,016, a reduction on 2009 of £212,335. This variance mainly arose as a result of a decrease in marketing expenditure totalling £580,000, offset by an increase in industry development expenditure totalling £125,000 and a reduction in grants received in the year totalling £220,000.

An exceptional item was identified relating to the release of a pension provision. The relevant member of staff retired during the year with no liability to QMS with the resulting pension provision being released back to the operating cost statement. This meant that QMS has reported an overall surplus for the year.

### Expenditure in 2009-10

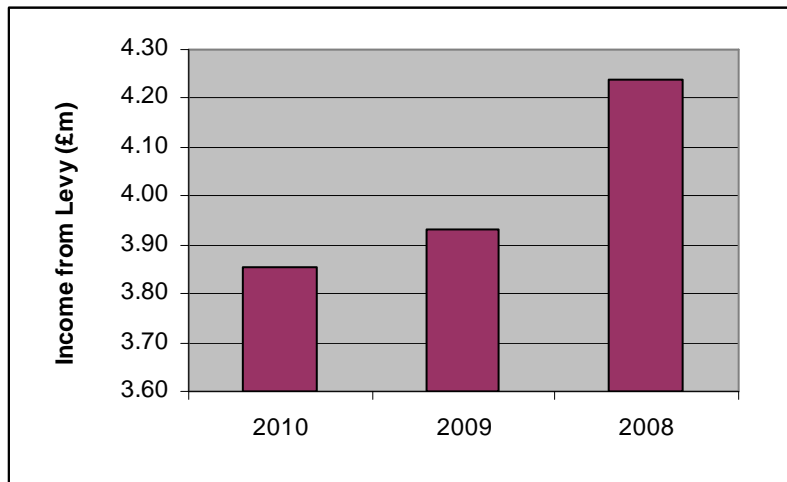
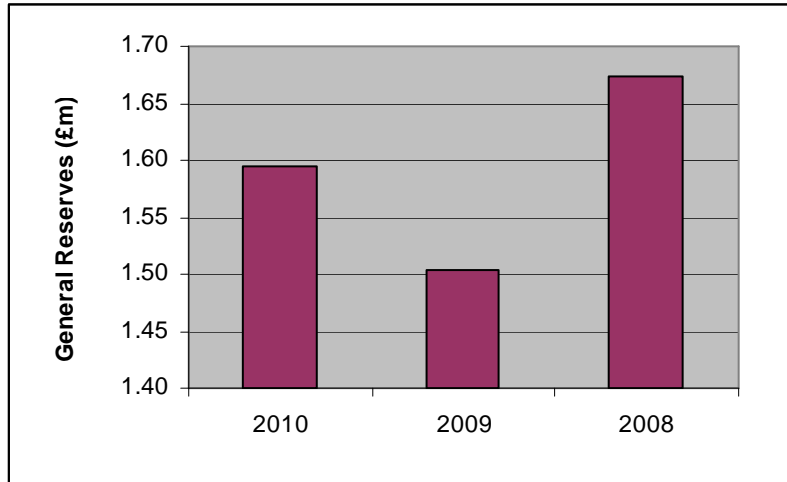
In 2009-10, QMS invested over a third of its total spend (around £2m) in marketing and promoting Scotland's three red meat brands, Scotch Beef, Scotch Lamb and Specially Selected Pork.

The second largest area of spend (23%) is on the assurance scheme that supports each of these brands, and ensures that only red meat of sufficient quality is accredited in terms of food safety, animal welfare and environmental protection. Fees generated from participating producers mean that the programme of assurance is self-financing.

Expenditure on industry development has increased to around 22% of QMS spend (2009: 18%). This reflects investment in delivering efficiency improvements across the three species of cattle, sheep and pigs.

We also noted that the cost of corporate services has continued to fall to £587k (2009: £594k). This reflects the organisation's continuing commitment to improving efficiency.

## 2.2 Financial Position as at year end 31 March



### General Fund Reserves

Our Audit Approach Memorandum identified the risk that the global economic crisis may mean that one or more of the abattoirs in Scotland could fail, with a significant impact on QMS. We also noted that the downturn is likely to impact on the UK meat industry as a whole. The impact on the General Fund following the temporary closure of one of the abattoirs following a fire in 2008-09 highlights the organisation's vulnerability.

QMS has acknowledged the risks of the recession both in its corporate plan, and in risk management processes. However, the differentiation that the Scottish red meat brands provide mean that by supporting the industry, QMS is securing its own sustainability. Research suggests that awareness of the brands remains high, and development work means that exports to key targets such as Italy and France are growing.

General fund reserves have increased to £1.67m during the year and exceed the minimum level held to meet unforeseen circumstances and contingent events (£1m). The balance is held to meet specific expenditure commitments.

QMS's income from the statutory levy has fallen over the last five years as a result of declining livestock numbers. However, in April 2010, new levy rates were introduced following consultation with the industry and the approval of the Rural Affairs Cabinet Secretary. The levy rates had previously been unchanged for 8 years. The new rates mean that in 2010-11, levy income is expected to rise to around £4.6m.

## 3 Financial Statements

### 3.1 Introduction

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 dated 14th April 2010.

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

#### Status of audit

The draft Financial Statements and supporting working papers were presented for audit on the 3 May 2010 and were of a high standard. This meant that no audit adjustments were required to be made to the accounts.

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

- review of the financial statements

### 3.2 Audit opinion

We intend to conclude that QMS's financial statements give a true and fair view of the financial position for the period from 1 April 2009 to 31 March 2010 and that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and relevant guidance. We confirm that information which comprises the management commentary, included with the Annual Report, is consistent with the financial statements.

### 3.3 Matters identified at the planning stage

	Issue	Auditor response
1	<p><b>Financial position</b></p> <p>QMS receives a significant proportion of its income from statutory levies paid by abattoirs. The slaughter market is dominated by a few large abattoirs.</p> <p>Given the global economic crisis, there is a risk that one or more of these abattoirs could fail with a consequent impact on QMS income.</p>	<p>We have reviewed QMS's financial position in section 2.2 and conclude that the reserves and risk management arrangements are sufficiently developed to respond to immediate concerns.</p> <p>During our interim audit, we also reviewed QMS's budget monitoring arrangements as part of our work on governance. We found that monthly management accounts are produced which compare budgets to actual outturn for each of the five departments. Explanations are sought against variances, and any issues are raised with both the Board and Senior Management. We are therefore satisfied that budget monitoring procedures are robust enough to highlight emerging issues and allow management and the Board to respond appropriately.</p>

	Issue	Auditor response
2	<p><b>International Financial Reporting Standards (IFRS)</b> Central government bodies are required to prepare their accounts on the basis of IFRS from 2009-2010. In readiness for this, QMS prepared an opening 2008 IFRS-based balance sheet which we have already reviewed and reported on.</p> <p>QMS has also produced full shadow IFRS accounts for 2008-09 by the due date of 30 November 2009.</p>	<p>We have carried out a comprehensive review of the draft 2009-10 IFRS accounts against the requirements of the 2009-10 FReM. There were various disclosure points to be amended and no material errors were identified.</p>
3	<p><b>Pension liability</b> We noted that the pension provision included in the 2008-09 financial statements was not based on an actuarial valuation and may not therefore reflect the actual liability due under existing arrangements.</p>	<p>In 2008-09, there was a pension provision totaling £100,000 included in the financial statements in respect of a part time employee who was a member of the Meat and Livestock Commission Pension Scheme, which is a defined benefit scheme. This provision existed as a result of the transfer of QMS 2000 Limited to a Non Departmental Public Body, whereby the liability arose under the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008.</p> <p>The employee retired on 29th March 2010. As there is no quantifiable liability that can be determined, the provision has been released to the operating cost statement in the current year. We reviewed the work performed by QMS to assess the likely impact and agreed with the treatment applied.</p>
4	<p><b>Cash held on deposit</b> We noted that QMS did not have a counter party limits policy in place in order to reduce risk in relation to treasury management. We recommended that the organisation should have a policy in place to determine how treasury management risk can be minimised through the use of counter party limits.</p>	<p>In October 2009, the Board approved a proposal to split strategic cash reserves between two financial institutions. Day to day banking remains with the Bank of Scotland and a deposit account is held with the Clydesdale Bank.</p>



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	Issue	Auditor response
5	<p><b>Audit Committee Handbook review</b></p> <p>At the time of our 2008-09 audit, the Audit Committee had not yet reviewed its performance in accordance with the guidelines issued by the Scottish Government.</p>	<p>During 2009-10, QMS's internal auditors conducted a review of governance arrangements. We reviewed their work to ensure that we were able to place reliance on their work for the purposes of our audit.</p> <p>The review drew on good practice guidance including the <i>On Board Guide for Board Members of Public Bodies in Scotland</i> and the <i>Good Governance Standard for Public Services</i>. The internal auditors highlighted a number of areas for minor improvement, including the implementation of arrangements for self-review of performance for the Board and its Committees.</p>

## 4 Best Value and Performance

### 4.1 Introduction

All public bodies in Scotland have a duty to secure Best Value and continuous improvement. The public sector is facing a period of significant financial austerity, with budget cuts likely to be in the region of 12-20% in real terms by 2013-14. Whilst QMS is self-financing, it is accountable to key stakeholders and there remains public pressure to deliver services as efficiently and cost effectively as possible. This means that being able to demonstrate that the organisation delivers Best Value is more important than ever.

### 4.2 Corporate Planning Processes

Our audit confirms that QMS has a well-developed corporate planning process in place, which links well with the organisation's resource management and budgets. The Corporate Plan ensures that everything the organisation does is aligned to the strategic aim: *to shape a sustainable and prosperous Scottish red meat industry* with specific strategies agreed and implemented to achieve the aim. Each strategy is clearly linked to objectives within the management plan, which cascade to team and individual objectives. Key performance indicators are set for each activity, although in future there may be scope to make indicators more outcome focused, in line with the Critical Success Factors identified in the Corporate Plan.

**Refer to Action Plan Point 1**

### 4.3 Engaging with Stakeholders

QMS's approach to engaging and communicating with stakeholders is also well-developed and comprehensive. The organisation has a number of mechanisms for engaging with key stakeholders and demonstrating accountability, including open meetings for people in the industry, levy payers involvement with advisory committees to the Board, and the Board's

Annual Review of performance. A review of corporate communications is also underway, which will aim to ensure that stakeholders can access the information they want in the most effective form for them.

QMS uses its links with the industry to help deliver its aims. Recent successes include a partnership with the Scottish SPCA and the pork industry. The Specially Selected Pork label became the first ever farm assurance and food labelling scheme independently approved by a national animal welfare charity following its launch in June last year. The collaboration was recognised in a Scotland Food and Drink national award for "Success through working in partnerships" in May 2010. Other partnerships include the Scotch Beef Club, which links with high quality restaurants to promote Scotch Beef both in the UK and abroad. QMS also works with partners such as Skills Development Scotland to address skills gaps in the meat industry.

### 4.4 Securing Continuous Improvement

QMS reviews its progress against the management plan on an annual basis. The review records that they achieved around 87% of tasks within the 2008-09 management plan, and a further 6% were partially achieved.

### 4.5 Looking Ahead

In its *Improving Public Sector Efficiency Report*<sup>1</sup>, Audit Scotland note that there is scope for public sector bodies to make significantly greater improvements in efficiency than have been achieved to date, and the need to do so is increasingly pressing. The report notes that public bodies still have insufficient information on unit costs and costs related to activity levels and

<sup>1</sup> Improving Public Sector Efficiency, Audit Scotland, February 2010

the quality of services. All public bodies need to understand better the relationship between costs, volume and quality of services to get improvements in productivity and reductions in cost.

Audit Scotland has produced a good practice checklist designed to challenge and support public bodies in making efficiency improvements. This approach may help QMS identify further areas for improvement, for example by focusing service reviews to ensure that each area of the business contributes to the key priorities identified within the Corporate Plan.

**Refer to Action Plan Point 2**

## 5 Action Plan

	Issue and risk	Assessment	Recommendation
1	<p><b>Outcome focused indicators</b></p> <p>Performance indicators are set for each activity, but there may be scope to make indicators more outcome focused, in line with the Critical Success Factors identified in the Corporate Plan. This would allow QMS to demonstrate trends across time, and the impact that their work has on the industry.</p>	Medium	<p>QMS should consider developing outcome based indicators, either as part of the targets within the management plan, or as Key Performance Indicators within the Corporate Plan.</p> <p><b>Management response:</b> During the planning cycle for the 2010/11-2012/13 Corporate and Business Plan (Jan/Feb 2010) the Chief Executive discussed in detail with the Senior Management Team the appropriateness of KPIs to describe achievement of a wide range of activities. It was agreed that the use of the term "Performance Measure" would help achieve a more outcome based approach.</p>
2	<p><b>Improving Efficiency Good Practice Checklist</b></p> <p>Audit Scotland's <i>Improving Public Sector Efficiency</i> report notes that all public bodies need to understand better the relationship between costs, volume and quality of services to get improvements in productivity and reductions in cost.</p> <p>Audit Scotland has produced a good practice checklist designed to challenge and support public bodies in making efficiency improvements.</p>	Medium	<p>QMS should use the good practice checklist to identify areas for continuous improvement, such as the development of unit cost information and focusing service reviews.</p> <p><b>Management response:</b> QMS is not a public sector provider. It was established as a public body to delivery a specific remit for the Scottish red meat industry following the recommendations of the Review of the Agricultural and Horticultural Levy Bodies (The Radcliffe Review). The Good Practice Checklist is helpful in that it identifies worthwhile "good practice areas". The detail however in the "Key points to consider" is only partially relevant. Management would like to discuss with the Audit Committee in what way the Good Practice Checklist can be used pragmatically to advance continuous improvement within the organisation.</p>

## 6 The small print

### Purpose of memorandum

This Key Issues Memorandum has been prepared for the benefit of discussions between Grant Thornton, the Accountable Officer and the Board.

The purpose of this memorandum is to highlight the key issues affecting the organisation's results and the preparation of the financial statements for the year ended 31st March 2010.

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 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 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 Accountable Officer 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's internal financial controls. In addition, the management 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 the management.

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

	£
Audit	12,000

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