

FINANCE AND MANAGEMENT CASE STUDY

Final Test of Professional Competence

12 June 2007

PRE-SEEN MATERIAL AND CASE FILE

Time allowed: 6 hours 10 minutes

Morning session Part 1: 9.45am – 12.15pm
Morning session Part 2: 12.20pm – 1.00pm
Afternoon sessions: 2.00pm – 5.00pm

The first session will end at 12.15 pm at which time Question 1, the quick response question, will be distributed to candidates. At 12.20 p.m. candidates will be given 40 minutes to answer this question, which will be collected at the end of the morning session. The remaining questions are set out below, so that candidates can work on these throughout the examination. All questions must be answered. The weightings for each question are indicated in the parentheses at the end of the question.

Nothing may be taken from the examination room during the lunch interval, nor may anything additional be brought into the afternoon session. It is against examination regulations for candidates to collude during the lunch break nor should there be any contact with academics.

The case study has been prepared on the assumption that candidates will not necessarily have a detailed knowledge of the type of organisation to which it refers. No additional merit will be accorded those candidates displaying such knowledge.

Candidates should submit all papers produced during the examination, but they should distinguish clearly between formal answers (including appendices) and working papers.

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QUESTIONS

NOTES TO CANDIDATES

- (i) Answers to be prepared as on 12 June 2007 by Sam Tipeed, Special Projects Officer at Gumerichshire County Council.
- (ii) The questions below are intended to test the candidate's understanding of the situation in the case.

QUESTIONS

2. Draft a report for the xParrot Limited Board on the 2006 accounts and related matters in accordance with the memorandum from the Director of Technical Services and Acting Managing Director of xParrot Limited dated 1 June 2007 (page 14). (42%)
3. Draft a report on xParrot's cash flow projections and capital financing options in accordance with the memorandum from Head of Financial Services and Interim Finance Director of xParrot Limited dated 8 June 2007 (pages 22 and 23). (38%)

A Disbursements Account pro-forma for Question 2 is attached.

REPUBLIC OF SAFARILAND

Background

Safariland is a small republic in central Africa which gained independence in the 1970s after many years as a UK protectorate. As a result, the Republic's governmental, legal and fiscal framework very much reflect those of the UK, with which close ties still remain. Whilst the Republic's economy relies heavily on tourism and the export of natural resources, mainly semi-precious stones, its temperate climate ensures that it is also self-sufficient in terms of food and in fact is a minor exporter of fruit. The Republic encourages an entrepreneurial approach and business is operated through a company-based system similar to that in the UK.

Government

Central Government is based upon a democratically elected National Assembly, with the majority party forming the Government, and a permanent civil service. Government is operated through a series of broad Departments, with more specific Ministries within each Department. In Safariland, the Ministry of Local Government forms part of the Department of the Environment.

Local government in Safariland is operated on a two-tier basis with County Councils responsible for strategic services such as education, social services, transportation and the environment and District Councils dealing with more local services and the collection of local taxes. Elections to both types of Councils take place every four years, but are staggered. The last County Council elections took place in May 2007 and the last District Council elections in May 2005. As with Central Government elections, the majority party takes power and all councils now operate a cabinet-based approach to government. The two main parties in Safariland are the Allied Popular and Equality (APE) party and the Conservative and Tory (CAT) party.

General Financial Environment

The Safariland £ equates to £1 sterling.

The financial year for all Government bodies runs from 1 April to 31 March. Companies have flexibility to select their own accounting year, but, in accordance with current legislation, they must be registered through Companies House and submit formal accounts within 6 months of their registered year-end. Following a series of financial scandals, the Safariland Government wishes all companies to adopt the recommendations of the Safariland Combined Code of Corporate Governance, which is based on the UK equivalent Combined Code of Corporate Governance (the Higgs Code).

Tax Regime

There are three main relevant Government taxes that are assessed and collected by the Government Office of Assessment and Taxation (GOAT).

- Remuneration Assessed Tax (RAT) is a personal tax on earned income. It is collected at source by employers (or their agents) and paid directly to the GOAT. There are statutory penalties for late and incorrect returns.
- Benefits Assurance Tax (BAT) is a tax levied on employment earnings payable by both employees and employers. It is collected at source by employers (or their agents) and paid directly to the GOAT. There are statutory penalties for employers who fail to administer BAT correctly.
- Business Income Return Deduction (BIRD) is a tax on the net profits of companies, levied on an annual basis. The principles of BIRD are similar to UK Corporation Tax.

There is no Value Added Tax (VAT) in the Republic of Safariland.

GAMERICHSHIRE COUNTY COUNCIL

Background

Gamerichshire County Council (GCC) is a medium-sized County Council in the East of Safariland. Gamerich, its main city and the location of County headquarters (County Hall), is also home to one of Safariland's leading universities. The County has 6 District Councils within its boundary.

Council & Political Leadership

In the May 2007 County Council elections, the Conservative and Tory (CAT) party, led by Sir Leigh Pard, lost power to the Allied Popular and Equality (APE) party under its leader, Jim Pansea.

Senior Management

Up to 31 March 2006, GCC's management structure was on traditional lines with 8 Chief Officers leading the various departments, under a Chief Executive Officer. With the impending retirement of a number of Chief Officers during 2006/07, including the County Treasurer, the opportunity was taken to introduce a revised structure based upon corporate directorships and this was fully implemented by 1 April 2007.

The current Chief Executive (CE), Ellie Fant, took up post relatively recently, having been recruited from the private sector when the previous incumbent (who had overseen the implementation of the new structure) retired on 31 March 2007. The CE is now supported by four Corporate Directors with the following responsibilities:

| <u>Officer</u> | <u>Director of</u> | <u>Service Details</u> |
|----------------|-------------------------|---|
| □ Blake Adder | Technical Services | Architecture, transportation, environment |
| □ Walt Hogg | Children's Services | Education, children |
| □ Koo Dew | Adult/Cultural Services | Libraries, recreation, culture, elderly, physically & mentally infirm |
| □ Ann Telope | Corporate Services | Finance, IT, personnel, legal, administration |

Technical Services

Blake Adder, the new Director of Technical Services, was formerly the County Architect & Engineer under the old structure. He has for many years been interested in using technology to develop computer-aided building and engineering design systems for use by architects, builders and civil and structural engineers. To progress this initiative, he recruited two architectural technicians with computer backgrounds in 2001 and established close links with Professor Yvon K. Gibbon, the Faculty Head of Computer Design at Gamerich University. In 2002 a prototype system was developed and then used both successfully and extensively by Blake Adder's staff for design purposes.

As a result, it was decided at that time to set up a company to finalise the research and development project and to ultimately market the product. The final development of the product required considerable technical input from the University's Faculty of Computer Design.

NORWEGIAN BLUE LIMITED**Norwegian Blue Limited - Creation**

The software development project and its product had always been known by the acronym PARROT – Public Architectural Real-time Realisations through Online Technology and, as a result, the company established in 2002 was named after Blake Adder's pet parrot, a Norwegian Blue. GCC was the majority shareholder (51%), with the University holding 49% of the equity. The intellectual property rights to the software were transferred to the new company. The two architectural technicians were seconded to the company and the company offices were established in County Hall, with GCC supplying all support functions and facilities.

As a result, Norwegian Blue Limited relied heavily on GCC for financial and administrative support throughout its existence, with the University, the other shareholder, acting in a consultancy capacity and contributing expertise when required. A first basic commercial version of PARROT was ready by early 2005, but it was accepted that, to be competitive and commercially successful, a new (Version 2) product needed developing that more fully met customers' expectations.

Onward development, however, proved much slower than expected. Consequently, sales were slow and profitability proved elusive. At the same time, relations with Professor Gibbon became very acrimonious, particularly as the company's debts to GCC for support services mounted. The University declined to provide any funding and disputes arose about the direction of development.

Norwegian Blue Limited - Demise

With these uncertainties persisting and the relationship continuing to be strained, all direction was lost and the resultant delays further worsened the company's financial position. In order to resolve matters, the County Council insisted that the company cancel all client support contracts (GCC paid the contractual compensation resulting from the cancellations) and forced through a Norwegian Blue Limited Board resolution to apply to the High Court for a winding up order under the Insolvency Act 1986. The order was granted and resulted in Norwegian Blue Limited going into administration on 30 September 2005. GCC was the only creditor and there were no debtors. Apart from some computers, office equipment and furniture, the only asset was the PARROT software rights.

PARROT potentially remained a valuable asset and had already built a reputation with other software houses. Blake Adder was eager for its development to be progressed and for its commercial potential to be realised. He therefore raised with the GCC Cabinet the possibility of setting up another company to take forward the development and marketing of the PARROT product. The GCC Cabinet expressed some concerns but ultimately agreed to fund an external consultancy report aimed at evaluating the software and its income-generating potential. In view of the urgency, the choice of consultant was left to Blake Adder.

xPARROT LIMITED**Consultant**

In the circumstances, Blake Adder approached an acquaintance of his from the private sector, namely Monty Python of Fly and Shirkers, a marketing consultancy partnership. Monty was appointed immediately to undertake the review exercise.

The subsequent report was presented to Cabinet in early November 2005 and in summary this supported the creation of a new company to take the PARROT product forward. Whilst there had been no time to develop a business plan as such, the report –

- ❑ Confirmed the expectation that there was a firm market for the PARROT product both within Safariland and internationally, particularly if the development of the more client-friendly Version 2 could be completed;
- ❑ Suggested that, to complete this work to the required standard, a partnership with an established software house, preferably with international experience, should be sought;
- ❑ Noted that breaking into this market would require a far greater emphasis on marketing and sales, and that this would require resourcing;
- ❑ Proposed the creation of a new company named xParrot Limited with the purpose of acquiring the assets of Norwegian Blue Limited from the Administrator.

Cabinet resolved that:-

“Subject to appropriate advice, the County Architect & Engineer should take whatever steps are necessary and correct in the interests of the Gumerichshire County Council to provide funding to secure the purchase of the assets of Norwegian Blue Limited from the Administrator and to set up a new company to develop and manage those assets in line with the Consultant’s report.”

Parrot Software Rights

The Administrator advertised the sale of the PARROT software rights and other assets in the Safari Times on 14 November 2005. A number of software houses submitted bids, but a bid of £240,000 by Blake Adder on behalf of GCC was successful in securing its purchase. Most of this, after deduction of the Administrator’s charges and expenses, was returned to GCC as the only creditor. A small residual balance was returned to the shareholders, at which point Norwegian Blue Limited was dead and ceased to exist.

The assets acquired by GCC comprised the intellectual property rights (IPR) of PARROT, and also its computers, office equipment and furniture, although these had already been fully written down and were deemed to have no residual value. There was no stock.

xPARROT LIMITED – STRUCTURE & ASSETS**Company and Management Structure**

In presenting his Cabinet report, Monty Python expressed an interest in continued involvement with the new company and, in view of his sales and marketing expertise and the urgency of the situation, he was invited by Blake Adder to become Managing Director of the new company, as soon as the PARROT rights (IPR) were acquired. He immediately approached a number of former colleagues to fill the key posts.

He also looked to develop a relationship with Cobra Technics, an Indian software company that he knew well. It was the right size and had the right expertise to help progress the PARROT product. Cobra Technics is headed by Ken Cobra.

Discussions took place in late November 2005 and, with the agreement of Blake Adder, resulted in the formation of xParrot Limited by Monty Python with the following share structure –

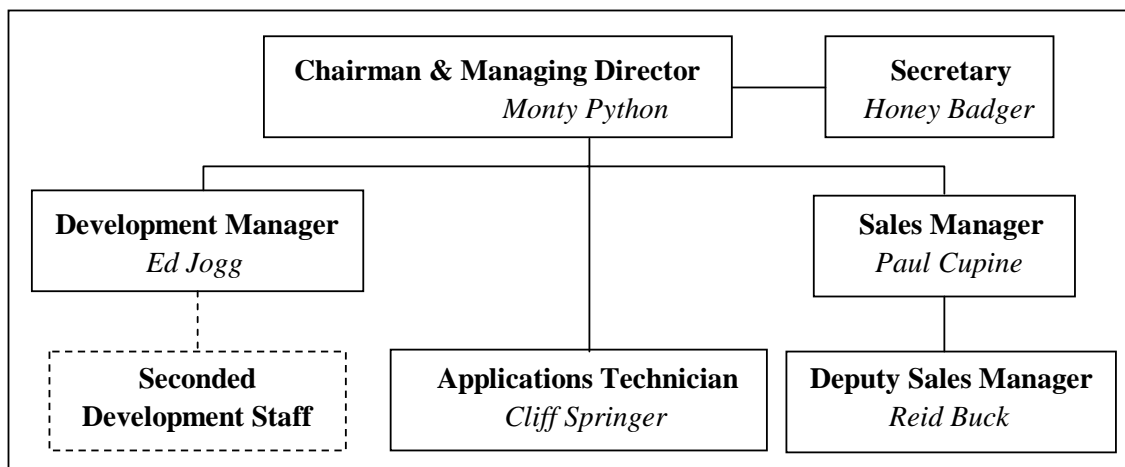
- ❑ Blake Adder (on behalf of GCC in his role as County Architect & Engineer) – 100 £1 shares
- ❑ Ken Cobra (a condition of participation by Cobra Technics) – 100 £1 shares
- ❑ Monty Python (part of his employment package to manage the company) – 100 £1 shares.

To oversee GCC's interest, it was agreed that the Council Leader and Deputy Leader would act as non-executive Directors of the new company. All the necessary documentation was submitted to and approved by Companies House in early December 2005 and the new company commenced trading on 1 January 2006. It adopted 1 January to 31 December as its accounting year. To reduce cost and regulatory burdens on small businesses, companies with a turnover of less than £5 million and net assets of less than £1.4 million may elect to dispense with an audit under Safariland company law. xParrot Limited expects to meet these conditions and therefore has elected not to have an audit.

GCC sold the former company's assets to the new company in exchange for a loan note issued by the new company, xParrot Limited, to GCC on the following agreed terms:

- ❑ The loan would be interest-free;
- ❑ In return, the County Council would continue to receive use of PARROT products without charge;
- ❑ The loan note will be repaid by 24 six-monthly instalments of £10,000, falling due on 30 June and 31 December each year, commencing 30 June 2006.

At the inaugural Board meeting of xParrot Limited, Monty Python was confirmed as Managing Director of the new company and put the following staffing structure in place, with all appointments commencing on 1 January 2006.



Premises, Furniture & Equipment

Business premises were hastily arranged on Bush Business Park, a facility operated by Savannah District Council for new and developing companies. A 10,000 square foot unit with appropriate offices and work areas was taken from 1 January 2006.

It was appreciated that the computers and other equipment acquired as part of the purchase of Norwegian Blue Limited's assets (all of which had already been fully written down) would need immediate upgrading at a cost of about £80,000 for the initial development of Version 2 and full replacement at a later date. The office equipment and furniture acquired as part of the Norwegian Blue Limited purchase were supplemented by items from GCC's surplus store at nil cost and nil value. All these assets were deemed to have a fair value of £Nil.

xPARROT LIMITED – FINANCIAL BACKGROUND

General

Despite GCC's shareholding and Blake Adder's involvement, xParrot Limited is a separate legal entity from GCC. Monty Python and his Board control the company. With the organisation being so small, Monty Python took responsibility for most of the financial aspects himself. His secretary, Honey Badger, operates a cash disbursement account for smaller items of expenditure, maintains the debtors' ledger and is responsible for chasing outstanding debtors.

Sales

Whilst Norwegian Blue Limited was involved solely with outright sale of its software plus ongoing support contracts, xParrot has widened this and now derives its sales income from a number of sources, all related directly or indirectly to the supply and installation of the PARROT product as follows –

- ❑ PARROT software that can be either –
 - Purchased outright with a supplementary support contact;
 - Rented on various bases to include updates and support;
- ❑ The installation of PARROT on client hardware;
- ❑ The provision of new hardware with PARROT already installed;
- ❑ The provision/installation of supplementary graphics and other related software –
 - On clients' own hardware;
 - On the new hardware provided;
- ❑ Training and help lines on PARROT and other software.

These mixed arrangements do mean that the direct income cash flows from the above sources can be uneven throughout the year.

Direct Costs

In the case of hardware, proprietary software and training, there are direct costs in terms of products and services bought in. Monty Python has established contracts with companies previously known to him as follows –

- ❑ Tarzantec Hardware for the supply of the hardware bought and then sold on to clients;
- ❑ Serengeti Software for the supply of graphics software bought and then sold on to clients and for training in its use;
- ❑ Crocoprint for the supply of manuals.

Such products are ordered specifically for the client concerned and usually delivered direct to the client's offices where installation and training take place. No stocks of hardware or software are therefore held by xParrot. Operating manuals are ordered specifically when required and supplied to the customer immediately, so there is no stock of printed manuals.

All products and services bought in are sold with a mark-up to reflect handling, installation and administration, but the actual level varies from client to client dependent upon the complexity of the work involved.

xPARROT LIMITED – FINANCIAL BACKGROUND (continued)**Overheads**

The company's overheads relate mainly to staffing and office expenses, but, as a result of the emphasis on generating sales and increasing income, also include expenditure on exhibitions and promotions, as well as travel and subsistence. All directly employed xParrot staff members have signed 3-year contracts on fixed terms commencing on January 1st 2006. An agency, Impala Payroll Services, is used to process the company's payroll and produce all statutory tax returns.

GCC Supplies

Through its central purchasing operation and car lease scheme, GCC has arranged for xParrot to be supplied with three vehicles. xParrot also orders supplies, particularly stationery and office supplies, from GCC's central store. The costs relating to both the leased cars and other supplies are invoiced to xParrot on a monthly basis.

Working Capital

The initial capital raised from investors was £300 (300 shares @ £1). Monty Python has opened an account at the bankers used by GCC, Safari & Hunting Banking Corporation (SHBC), and has arranged an overdraft facility to provide working capital for the new company. SHBC is one of the major banks in Safariland and has a good international reputation. Monty Python considered that there was no need for any working capital as SHBC had agreed to extend an overdraft facility of £150,000 to the company. Whilst this was technically repayable on demand, the bank expected that GCC would, if necessary, support the company financially.

Development Costs

In addition to the Development Manager, staff from both GCC and Cobra Technics have an input to development of PARROT Version 2 as follows –

- ❑ GCC – the two staff previously involved with PARROT have been seconded to xParrot for 2 years (1 January 2006 to 31 December 2007) at a cost of £5,000 per month (£60,000 per annum);
- ❑ Cobra Technics – technical support is being provided on the basis of a 5-year agreement costed as follows –
 - Year 1 (2006) - £30,000 per month (£360,000 per annum)
 - Year 2 (2007) - £15,000 per month (£180,000 per annum)
 - Thereafter - £5,000 per month (£60,000 per annum)

There are contracts in place for all these arrangements, with the periods and terms geared to the development and maintenance of PARROT Version 2. All these development costs plus the intellectual property rights acquired from GCC are treated as capital expenditure in the accounts of xParrot Limited. The fair value of the intellectual rights was assessed at £240,000 by xParrot's management.

Financial Planning

Whilst no formal business plans were established, Monty Python did produce an Outline Income & Expenditure Plan for 2006 and this is shown overleaf.

xPARROT LIMITED – FINANCIAL PLANS**OUTLINE INCOME & EXPENDITURE PLAN 2006**

| Revenue | | Note | £ | £ |
|----------------|-------------------------------|------|---------------|-----------------------|
| Sales | Hardware bought in | | | 270,000 |
| | Software & training bought in | | | 80,000 |
| | Software (PARROT) | | | 650,000 |
| | | | | <u>1,000,000</u> |
| Direct Costs | | 1 | | <u>330,000</u> |
| Gross Surplus | | | | 670,000 |
| Overheads | Payroll | 2 | 190,000 | |
| | Premises | 3 | 26,000 | |
| | Travel & Subsistence | 4 | 100,000 | |
| | Office Equipment | 5 | 4,000 | |
| | Office Expenses | 6 | 20,000 | |
| | Gifts & Hospitality | | 5,000 | |
| | Exhibitions and Promotions | | 65,000 | |
| | Miscellaneous | 7 | <u>10,000</u> | |
| | | | | 420,000 |
| Net Surplus | | | | <u>250,000</u> |

Notes

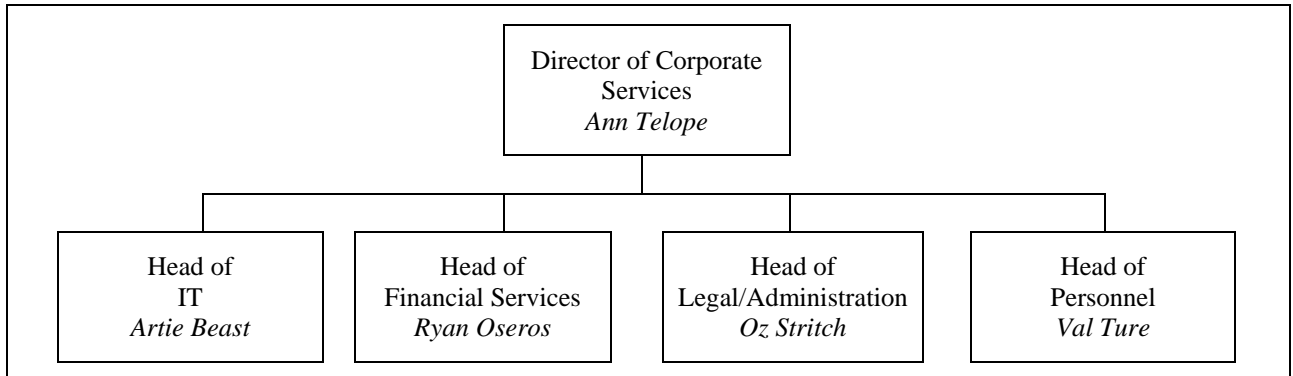
- 1 Hardware, software & training bought in
- 2 Excludes Development staff remuneration
- 3 Rent & utilities
- 4 Travel & subsistence claims including overseas travel
- 5 Photocopier lease and minor office equipment
- 6 Telephones, stationery & general office expenses
- 7 Directors' expenses, bank interest & charges

| Capital Expenditure | | £ |
|----------------------------|--|-----------------------|
| Development Manager | | 40,000 |
| GCC Secondments | | 60,000 |
| Cobra Technics Input | | <u>360,000</u> |
| | | 460,000 |
| PARROT Rights (IPR) | | 240,000 |
| Equipment Upgrade Estimate | | <u>80,000</u> |
| | | <u>780,000</u> |

GAMERICHSIRE COUNTY COUNCIL – CORPORATE SERVICES

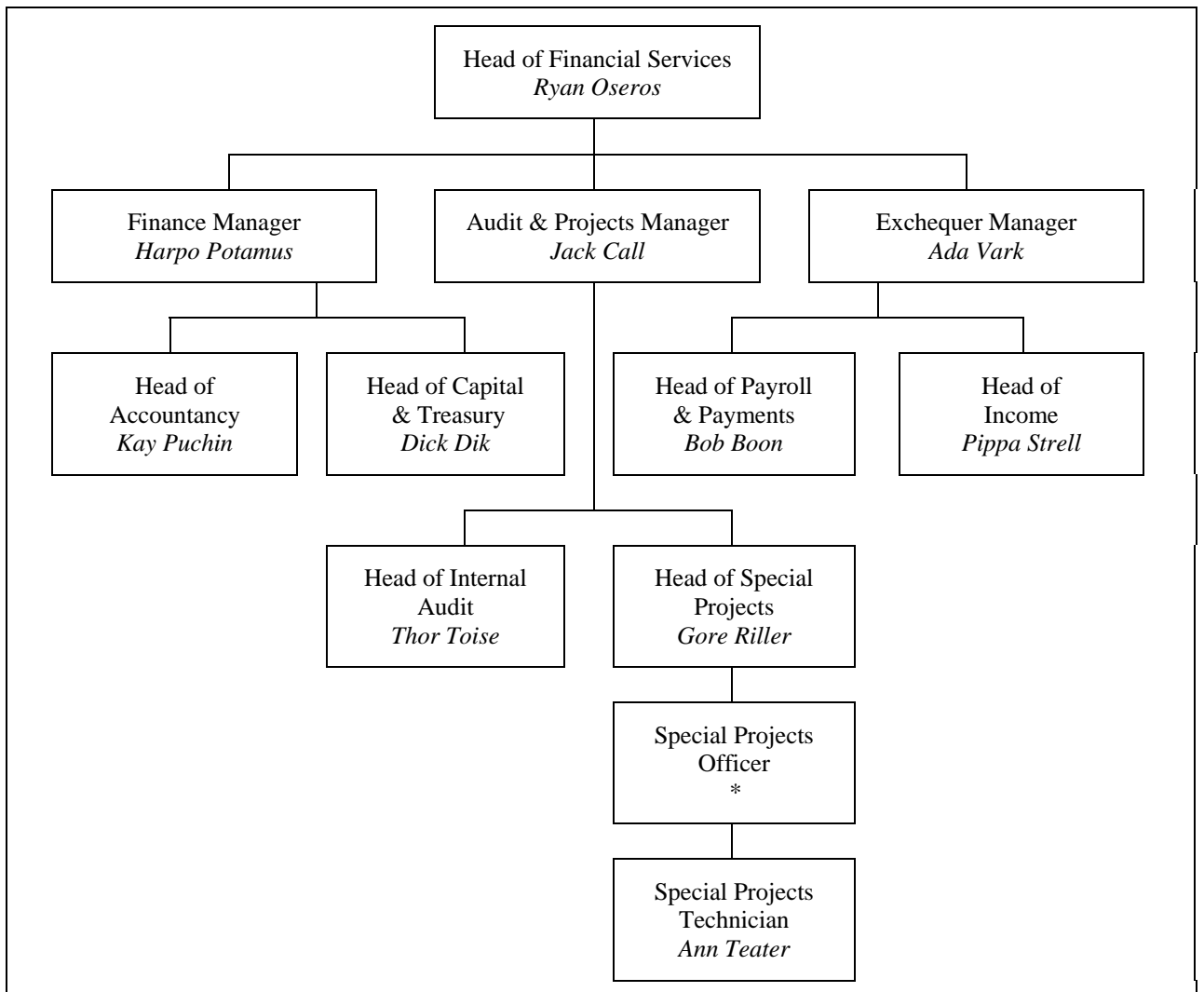
Corporate Services Directorate

The Corporate Services Directorate at GCC is made up of four departments and its structure is as follows.



Financial Services Department

The structure of the Financial Services Department is set out below.



* You are Sam Tipeed, the Special Projects Officer in the Financial Services Department.



GAMERICHSIRE COUNTY COUNCIL

FILE NUMBER : *PROJ 7 07/08*

HELD BY : *Head of Special Projects*

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| 3 | Memorandum from the Head of Financial Services and Interim Finance Director of xParrot Limited to the Director of Technical Services and Acting Managing Director of xParrot Limited re assistance with xParrot Limited. | 14/05/07 |
| 4 | Letter from Honey Badger at xParrot to Sam Tipeed, Special Projects Officer, on key financial areas at xParrot. | 17/05/07 |
| 5 | Letter from Savannah District Council to Managing Director of xParrot Limited re rent issues for the units occupied by xParrot on Bush Business Park. | 23/05/07 |
| 6 - 7 | File note by Ann Teater, Special Projects Technician, re various xParrot accounting matters, with an annotated bank statement to 31 December 2006. | 24/05/07 |
| 8 | Letter from Impala Payroll Services to Sam Tipeed, Special Projects Officer, setting out details of advances received and payments made in respect of xParrot staff pay/expenses. | 25/05/07 |
| 9 | E-mail from the xParrot Sales Manager to Ann Teater, Special Projects Technician, with an analysis of 2006 sales. | 28/05/07 |
| 10 | Memorandum from the Director of Technical Services and Acting Managing Director of xParrot Limited to Sam Tipeed, Special Projects Officer, re the planned development costs for the PARROT product, the cost of the Phase I computer peripherals upgrade programme and payroll advances. | 29/05/07 |
| 11 | Minutes of the xParrot Board meeting. | 30/05/07 |
| 12-13 | Letter from the Development Manager at xParrot to Sam Tipeed, Special Projects Officer, re the financing options for the Phase II hardware upgrade and replacement programme and the amortisation of development costs, attaching a quotation letter from Kilimanjaro Hardware. | 31/05/07 |
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| 17 | Letter from the Head of Income at Gamerichshire County Council to Blake Adder, Director of Technical Services and Acting Managing Director of xParrot Limited, setting out details of the monies owed by xParrot to the County Council. | 04/06/07 |
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| 21 | E-mail from the Sales Manager at xParrot to Sam Tipeed, Special Projects Officer, re trade creditors at 31 December 2006 and projections re likely sales levels and exhibitions expenditure going forward. | 07/06/07 |
| 22-25 | Memorandum from the Head of Financial Services and Interim Finance Director of xParrot Limited to Sam Tipeed, Special Projects Officer, requesting a report appraising cash management and capital financing options, attaching a cash flow projection to June 2008 and an analysis of daily bank balances for a representative period. | 08/06/07 |
| 26 | Letter from Cobra Technics to Blake Adder, Director of Technical Services and Acting Managing Director of xParrot Limited, re the phased payment of amounts owing to Cobra Technics and Gamerichshire County Council. | 11/06/07 |

GAMERICHSHIRE MEMORANDUM

TO : Ann Telope, Director of Corporate Services
FROM : Blake Adder, Director of Technical Services/Acting Managing Director of xParrot
DATE : 8 May 2007

xParrot Limited

Further to our brief telephone conversation, I set out below, as requested, my concerns about the management and particularly the financial position of the above company.

I have had a long involvement with the development of the PARROT design software, first through Norwegian Blue Limited, which went into administration, and more recently with the new company, xParrot Limited. I have used the PARROT product in-house at GCC for several years now in place of commercially available software, which is both inferior and costly (at least £8,000 per annum in licence fees). xParrot Limited was established to exploit the PARROT rights (IPR) and to develop this software on a commercial basis in a joint venture with Ken Cobra (Cobra Technics) and Monty Python, the consultant who initially advised upon the establishment of xParrot Limited. Both hold 100 shares in the company, as do I (on behalf of GCC). Monty became Managing Director, whilst Ken and I are directors. The GCC Leader and Deputy Leader are both non-executive directors.

I have known Monty for many years and his expertise is primarily in sales and marketing; he has no formal financial qualifications. Despite this and concerns raised by Board members, Monty took responsibility for all the company's finances, as well as leading on sales.

As a result of my broader GCC commitments, I tended to leave the running of xParrot Limited to Monty. Whilst an excellent salesman, Monty's communication skills with fellow Board members proved rather less well developed and he tended to contact me only when necessary "in his view", such that telephone conversations between us took place infrequently. Consultation, therefore, was minimal and progress updates were both uncommon and brief. However, Monty did call a Board meeting early in January 2007 (minutes attached) where he reported briefly on the 2006 financials. He painted a very positive picture of the progress made to date and the company's prospects.

However, since then the situation has deteriorated dramatically. The company's cash flow appeared to worsen significantly in the early months of 2007 and discussions with the company's bankers resulted in the overdraft limit having to be increased at the end of March. At the same time, there was no sign of the formal 2006 accounts being produced and I started to push Monty for these. In mid-April, Monty took a week's leave and never returned to work. He apparently broke down with stress and his doctor has indicated formally that he will not be returning to work for at least 3 months. Informally, the forecast is much longer and he has gone abroad to recuperate. Since late April therefore I have been Acting Managing Director. One of my first actions was to notify SHBC, xParrot's bankers, and to take over as signatory on the bank account.

The company clearly needs assistance to close the 2006 accounts at least and I hoped that your Head of Financial Services might help, albeit on a temporary basis. I would be very grateful on a personal level, but, of course, the Council and its leadership also have a vested interest in the company and would no doubt appreciate your support in this matter.

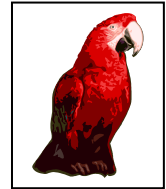
Blake Adder

Director of Technical Services/Acting Managing Director of xParrot

xPARROT

MINUTES OF BOARD MEETING

12 JANUARY 2007



Present : Monty Python (MP – Managing Director), Blake Adder (BA – Director), Ken Cobra (KC – Director), Councillor Sir Leigh Pard (LP – Leader & Non-Executive Director), Honey Badger (HB – Secretary)

1. Apologies

Walter Buffalow (Deputy Leader & Non-Executive Director)

2. Minutes of Board Meeting – 15 December 2006

The minutes of the inaugural Board Meeting were approved. Under matters arising, BA asked who would be responsible for production of the annual accounts as this decision was deferred at the last meeting. MP responded that this would be decided before the 2006 accounts were required. The meeting agreed to dispense with an audit as the company would meet the conditions (turnover below £5 million and its net assets below £1.4 million).

3. Interim Report 2006

MP presented a verbal report on 2006. He noted that the key tasks early in 2006 had been to contact former clients and to re-establish support contracts, as well as following up a number of potential PARROT clients who were discussing terms with Norwegian Blue Limited at the time of its demise. This had gone well and resulted in the receipt of almost £100,000 in January 2006. In the first half of the year, the emphasis had therefore been on re-establishing the company in the market, establishing credibility with potential clients and following up known contacts, as well as progressing the development of PARROT Version 2. In the second half of the year, the focus had been more on marketing, where he personally continued to take the lead, and particularly on preparing the ground for the launch of Version 2 in mid-2007. He noted that interest in this development had been considerable at both the major software events where PARROT had been exhibited, particularly the one in Beijing. He thanked both the Leader and Deputy Leader for their participation in that event.

On the financials, MP said that sales for 2006 had exceeded £950,000, slightly down on the £1 million projected. However, the end of December 2006 bank statement showed that direct payments (hardware, software etc.) were below £260,000, producing a gross surplus ahead of plan. Overheads were also being tightly controlled and cash flow was also generally good with a positive bank balance of almost £50,000 at 31 December 2006.

BA asked about debtor levels and whether income due was actually being received. MP expressed his confidence that this was the case, but asked HB to respond specifically, as she maintained the debtors ledger and was responsible for chasing debtors. HB noted that recovery was generally prompt, but that there was one former client where payment was still outstanding despite several reminders. The position on this was being closely monitored.

Resolved : To receive the verbal report

4. Prospects 2007

MP suggested that net sales in the first half of 2007 were likely to be up on 2006 and that the interest already shown in Version 2 should ensure that net direct revenues for the year as a whole would increase significantly. He added that he expected that 2007 trading would surpass the solid start made in 2006. BA asked whether MP had drawn up any forward-looking plans for the company. MP noted that he disliked formal planning and preferred a more flexible approach. KC supported BA's request for a more formal approach.

Resolved : To require MP to produce written forward plans for the next Board meeting.

[END]

GAMERICHSHIRE MEMORANDUM

TO : Blake Adder, Director of Technical Services/Acting Managing Director of xParrot
FROM : Ryan Oseros, Head of Financial Services/Interim Finance Director of xParrot
DATE : 14 May 2007

xParrot Limited

I understand that the Director of Corporate Services has already telephoned you to confirm that she is willing to assist with the difficulties at xParrot Limited and to agree to my appointment as Interim Finance Director. As you know, she cleared this with both the Chief Executive and the Council Leader, who agreed that the assistance given should be specific and short-term and that there should be no charge to xParrot for the services provided.

On the basis of your memorandum and the papers provided so far, there would appear to be two separate, yet related issues to be resolved as a matter of urgency –

- The production of the 2006 management accounts for xParrot (Profit and Loss Account and Balance Sheet) from whatever records currently exist at the company – these will later be used as the basis for the statutory accounts;
- Consideration of the company's current and future cash flows and the adequacy of existing working capital arrangements to confirm that xParrot is a going concern. The acid test of the company's viability is whether it will remain solvent during the period to June 2008 when development costs will be heavy.

These two exercises will clearly inform the view taken of the company's prospects. In order to make urgent progress, I have asked my Special Projects Officer, Sam Tipeed, to focus on the above tasks. Normally, I would have asked Gore Riller to take overall responsibility for this, but he is on long-term sick leave with no date for a return to work. Sam will be assisted by Ann Teater as Special Projects Technician and they will no doubt be visiting the xParrot offices shortly. In the meantime, please ask the key staff at xParrot, particularly Monty Python's secretary, to pass any relevant papers and correspondence directly to Sam.

I intend to stay personally involved at a strategic level and I should be grateful if you would arrange a Board of Directors meeting for a couple of week's time to confirm my position as Interim Finance Director. By that time, Sam should also have gathered together sufficient information to identify the key issues. Resolution of some of these may well require Board decisions.

I will liaise with you later on the agenda for that Board meeting. In the meantime, please inform all xParrot personnel of my involvement and that of my staff in order to ensure the fullest cooperation in what are likely to be intensive and difficult exercises.

Ryan Oseros

Head of Financial Services and Interim Finance Director of xParrot

Copies : Ann Telope (Director of Corporate Services)
Sam Tipeed (Special Projects Officer)

Sam

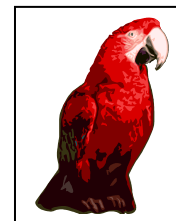
Further to our telephone chat, finish off any immediate work and then concentrate on the above project. I will talk to you later about the Board meeting agenda.

Ryan

Sam Tipeed
Special Projects Officer
County Hall
Gamerich GA1 1AA

17 May 2007

xPARROT
Bush Business Park
Gamerich
GA1 3EF



Dear Sam,

Financial information

I look forward to meeting Ann Teater when she calls in next week and I set out below some notes on areas identified by her on the telephone as key to your early work on the accounts.

Bank Account (10056659)

xParrot's bank account is with Safari & Hunting Banking Corporation (SHBC) and I have for Ann the bank statement to 31 December 2006, showing a positive balance of £49,451.09. This positive bank balance is slightly misleading as the account was overdrawn for most of the year on the basis of an agreed overdraft limit of £100,000 at that time. Please also note that £11,360 of sales and licence income, received on 29 December 2006 and relating to 2006, was not banked until 2 January 2007, together with a cheque for £500 dated 8 November 2006 for September quarter sub-let rent that I found on Mr Python's desk when he went off. The sub-let is to Mr Python's brother who continues to run a small software supply company from here and who should pay £500 per quarter (due on the last day of each quarter). Mr Python was the sole signatory on the account. I was made responsible for control of utility and telephone bills (after Mr Python lost the first telephone bill).

Cash Disbursements Account

This account is a cash float used for smaller items of expenditure by Mr Python and myself. An initial cash advance of £5,000 was topped up quarterly by Mr Python on the basis of actual payments made (analysis below). At 31 December 2006, I held £854.34 in cash and £143.87 in stamps. The Quarter 4 top-up cheque (001030), drawn on 29 December 2006, was not cashed until 3 January 2007.

| | Office Equipment | Office Expenses | Gifts & Hospitality | Miscellaneous | Total |
|-----------|---------------------|--------------------|------------------------|-----------------|------------------|
| | £ | £ | £ | £ | £ |
| Quarter 1 | 1,095.50 | 600.35 | 1,121.55 | 1,240.76 | 4,058.16 |
| Quarter 2 | 1,023.49 | 554.76 | 541.56 | 1,432.01 | 3,551.82 |
| Quarter 3 | 1,012.95 | 662.66 | 1,764.45 | 1,385.71 | 4,825.77 |
| Quarter 4 | 1,039.00 | 519.20 | 1,094.19 | 1,349.40 | 4,001.79 |
| | 4,170.94 | 2,336.97 | 4,521.75 | 5,407.88 | 16,437.54 |

Debtors Ledger

I maintain the ledger. Trade debtors at 31 December 2006 totalled £82,150 (£29,500 relates to hardware sales, £5,650 for software resales and £47,000 for PARROT software). There was a further £500 outstanding (sub-let rent) for the December 2006 quarter. However, I have since heard that one of these year-end debtors, Rift Valley Ventures, which owes £39,400 (hardware £12,250, bought-in software £3,500 and own software £23,650) is now in administration and that any recovery of monies due is unlikely.

I will pass all relevant correspondence on to you. Ring if you need any further information.

Yours sincerely

Honey Badger



SAVANNAH DISTRICT COUNCIL

**COUNCIL OFFICES
MASAI MARA ROAD
SAVANNAH TOWN
GAMERICHSHIRE
SA1 1AB**

Mr Monty Python
Managing Director
xParrot Limited
Gamerich Business Park
Gamerich
GA1 3EF

23 May 2007

Dear Mr Python

Breach of Terms of Tenancy Agreement

I am writing to remind you about the terms of the contract for the 10,000 square foot starter unit occupied by xParrot Limited on Bush Business Park.

- ❑ Firstly, the unit was let on preferential terms with rent per square foot per annum on a sliding scale over the first 4 years - £1 in calendar 2006, £2 in 2007, £3 in 2008 and £4 in 2009. Rent is due in arrears on the basis of two instalments each year to be received before 30 June and 31 December. I have to point out that the June 2006 instalment was not received until early September 2006 and the December 2006 payment not until late April 2007.
- ❑ Secondly, the contract signed prohibited any sub-letting. However, I understand from my contacts at the Park that you have sub-let one of the offices in the starter unit and are receiving rent from the occupant contrary to the terms of the contract.

Currently, therefore, you are in breach of the agreed terms on two grounds and, unless both issues are addressed as a matter of urgency, I will be obliged to consider invoking the termination clause in the contract.

I am aware of the company's strong connections with Gamerichshire County Council and I am eager to avoid any embarrassment for our colleagues in that authority. I hope very much, therefore, that these matters can be resolved amicably and to our satisfaction.

Yours sincerely

G Raffe

Head of Economic Development

I have terminated the sub-let with immediate effect and have agreed with Monty's brother that the payment due for the March 2007 quarter will be the final one.

Blake

FILE NOTE – xParrot Accounting Matters

Whilst I had brief sessions with the two managers, Ed Jogg and Paul Cupine, I spent the most time with Honey Badger. Her role, whether by design or necessity, is much broader than her title and her records on disbursements and the debtors ledger are excellent. Sadly, her areas of responsibility were limited. Monty Python retained “control” of most areas, including all contracts and cheque payments, and therein lies the problem. His records are poor at best and non-existent in most cases, so most will have to be recreated from documentation held by the managers and other staff. However, I did make some useful progress as detailed below.

- Bank Account - I attach the bank statement to end December 2006, annotated with details of payments made and receipts banked from cheque and paying-in book stubs. Bank charges are based upon a flat £100 per month for transactions and the overdraft facilities. Interest is charged at 7% per annum on overdrawn balances, calculated daily but payable 6-monthly in arrears. Four cheques for payments due in 2006 had not been presented at 31 December 2006 in addition to the disbursements account cheque of £4,001.79:
 - Cobra Technics – £25,000 (001027-28 November 2006) - Development
 - Cobra Technics – £25,000 (001031-29 December 2006) - Development
 - Tarzantec Hardware - £39,820 (001028- 27 December 2006) – Hardware for resale
 - Pink Panther - £16,900 (001029–28 December 2006) – Promotions/exhibitions

The earlier Cobra Technics cheque seemed to have been deliberately held back. As 31st December fell on a weekend, the second half year bank charges/interest of £1,925.66 did not appear on the bank statement until 3rd January 2007 but is a 2006 cash book item.

- Payroll Services - I have contacted Impala Payroll Services and it is sending me details of the position at 31 December 2006.
- Creditors – All staff have agreed to go through their records to identify the monies due to trade creditors at 31 December 2006. xParrot payments are also due to both Cobra Technics and GCC for services and goods provided. Some are capital payments (development work); others are revenue. I have asked the Director of Technical Services to clarify the capital items and GCC debtors staff to provide details of xParrot’s debts.
- Cash Flow - Honey has started constructing a cash flow projection for the current year using an agreed format and has almost completed the first 3 months. I have also asked both managers to give some thought to future sales and expenditure projections.

BIRD Taxation

As requested, I took advice on this and set out below the relevant parts of the current scheme.

- There are 3 rates of BIRD for 2006 – starting (0%), small companies (19%), full (30%).
- These rates are levied on a company’s chargeable profits – the company’s normal trading profits with depreciation and excluded items such as client gifts/hospitality added back.
- However, capital allowances on plant and equipment (at 25% per annum on a reducing balance basis) are deductible. This is the maximum allowed even for smaller companies.
- Amortisation of intangible fixed assets (patents, rights development) can be deducted.
- The applicable rate of BIRD and its computation can be summarised as follows.

| <u>Profit for period (£)</u> | <u>Applicable rate of tax</u> | <u>Fraction (F)</u> | <u>Marginal Relief (R)</u> |
|------------------------------|-------------------------------|---------------------|--|
| 0 - 10,000 | 0% | | $R = F \times (M - P) \times I/P$ Where - M = Band Upper Limit I = Chargeable Profits P=Profits * |
| 10,001 - 50,000 | 19% less marginal relief | F=19/400 | |
| 50,001 - 300,000 | 19% | | |
| 300,001 - 1,500,000 | 30% less marginal relief | F=11/400 | |
| 1,500,001 - | 30% | | |

* Chargeable profits plus franked investment income (nil in the case of xParrot)

Ann Teater

24 May 2007



Safari & Hunting Banking Corp

“tracking down the right terms for you”

| Account 10056659 – xParrot | | 2 January 2007 (OD – Overdrawn) | |
|----------------------------|-------------------|---------------------------------|---|
| | £ | £ | £ |
| | DR | CR | Balance |
| 02-Jan-06 1001 | 5,000.00 | | (5,000.00) OD Set up disbursements float |
| 13-Jan-06 Direct Debit | 90,000.00 | | (95,000.00) OD Impala – payroll agency advance |
| 16-Jan-06 Paid in | | 99,230.00 | Sales & licence income |
| Paid in | | 300.00 | Share capital |
| 1003 | 78,146.00 | | (73,616.00) OD Kilimanjaro – computers etc. for xParrot |
| 17-Jan-06 1002 | 22,500.00 | | (96,116.00) OD Crocoprint – manuals |
| 07-Mar-06 Paid in | | 52,340.00 | (43,776.00) OD Sales & licence income |
| 31-Mar-06 1004 | 4,058.16 | | (47,834.16) OD Disbursements a/c top-up |
| 03-Apr-06 Paid in | | 53,970.00 | Sales & licence income |
| 1005 | 9,864.00 | | Tarzantec – hardware for resale |
| 1006 | 4,987.48 | | (8,715.64) OD GNU – utilities – quarterly bill |
| 14-Apr-06 Direct Debit | 90,000.00 | | (98,715.64) OD Impala – payroll agency advance |
| 02-Jun-06 Paid in | | 74,560.00 | (24,155.64) OD Sales & licence income |
| 05-Jun-06 1008 | 32,350.00 | | Tarzantec – hardware for resale |
| 1009 | 10,042.00 | | (66,547.64) OD Serengeti – Software/training for resale |
| 30-Jun-06 1010 | 3,551.82 | | (70,099.46) OD Disbursements float top-up |
| 03-Jul-06 Int/charges | 3,560.98 | | (73,660.44) OD Bank interest/charges |
| 06-Jul-06 1007 | 10,000.00 | | (83,660.44) OD Camerichshire – loan note |
| 13-Jul-06 Paid in | | 110,245.00 | Sales & licence income |
| 1011 | 15,000.00 | | Cobra Technics – development costs |
| Direct Debit | 90,000.00 | | (78,415.44) OD Impala – payroll agency advance |
| 18-Jul-06 1014 | 5,672.31 | | (84,087.75) OD GNU – utilities – quarterly bill |
| 26-Jul-06 1012 | 6,745.89 | | (90,833.64) OD Bushcom – telephones – two quarters |
| 22-Aug-06 Paid in | | 105,670.00 | Sales & licence income |
| 1013 | 51,893.00 | | (37,056.64) OD Tarzantec – hardware for resale |
| 23-Aug-06 1016 | 15,000.00 | | (52,056.64) OD Cobra Technics – development costs |
| 06-Sep-06 1015 | 5,000.00 | | (57,056.64) OD Savannah DC – rent etc – ½ year |
| 14-Sep-06 1017 | 15,998.00 | | (73,054.64) OD Serengeti – Software/training for resale |
| 27-Sep-06 Paid in | | 118,350.00 | Sales & licence income |
| Paid in | | 1,000.00 | Rent – sub-let |
| 1019 | 25,800.00 | | Pink Panther – promotions/exhibitions |
| 1018 | 20,000.00 | | 495.36 OD Cobra Technics – development costs |
| 29-Sep-06 1020 | 4,825.77 | | (4,330.41) OD Disbursements float top-up |
| 10-Oct-06 1021 | 4,672.49 | | (9,002.90) OD GNU – utilities – quarterly bill |
| 12-Oct-06 Direct Debit | 90,000.00 | | (99,002.90) OD Impala – payroll agency advance |
| 23-Oct-06 Paid in | | 106,650.00 | Sales & licence income |
| 1024 | 58,794.00 | | (51,146.90) OD Tarzantec – hardware for resale |
| 26-Oct-06 1022 | 20,000.00 | | (71,146.90) OD Cobra Technics – development costs |
| 07-Nov-06 1023 | 7,981.45 | | (79,128.35) OD Crocoprint – manuals |
| 08-Nov-06 1025 | 2,951.56 | | (82,079.91) OD Bushcom – telephones – third quarter |
| 22-Nov-06 1026 | 6,179.00 | | (88,258.91) OD Serengeti – Software/training for resale |
| 28-Nov-06 Paid in | | 79,370.00 | (8,888.91) OD Sales & licence income |
| 15-Dec-06 Paid in | | 58,340.00 | 49,451.09 Sales & licence income |
| | 810,573.91 | 860,025.00 | |

SHBC ~ Camerich Branch ~ Thorn Tree Avenue ~ Camerich ~ CA1 4DE



IMPALA PAYROLL SERVICES

GAZELLE HOUSE ~ ANTELOPE LANE ~ SAVANNAH TOWN ~ SA3 2JW

"Your business is dear to us"

Sam Tipeed
Special Projects Officer
County Hall
Gamerich GA1 1AA

25 May 2007

Dear Mr Tipeed

xParrot Limited Payroll

Further to your telephone call, I have now cleared your request with xParrot Limited and set out below the analysis required for the period to 31 December 2006. This information had already been supplied to Monty Python early in January 2007.

As you may be aware, an advance of £90,000 per quarter is made by xParrot to Impala (£360,000 per annum) to cover pay costs, travel and subsistence (T & S) expenses and our annual agency fee of £8,000. The costs below are allocated between revenue and capital for accounting purposes, as per xParrot's instructions. As can be seen, we held a credit balance of £60,000 at 31 December 2006. Because of a cash flow crisis, Mr Python at xParrot asked if the advance due in January 2007 could be held back until February 2007 and I agreed to this, as a one-off event.

| | | Pay £ | T & S £ | Total £ |
|----------------|----------------|------------|------------|-------------------|
| <u>Revenue</u> | Monty Python | 73,675.67 | 33,892.03 | 107,567.70 |
| | Paul Cupine | 40,561.35 | 21,076.57 | 61,637.92 |
| | Reid Buck | 29,743.62 | 9,734.77 | 39,478.39 |
| | Cliff Springer | 24,950.90 | 3,267.85 | 28,218.75 |
| | Honey Badger | 14,876.59 | 220.65 | 15,097.24 |
| | | 183,808.13 | 68,191.87 | 252,000.00 |
| | Agency Fee | | | 8,000.00 |
| | | 183,808.13 | 68,191.87 | 260,000.00 |
| <u>Capital</u> | Ed Jogg | 39,120.51 | 879.49 | 40,000.00 |
| Total | | | | 300,000.00 |

You also asked about any problem areas. Impala provides a comprehensive service including the completion of all statutory returns, which are sent to employers for signing and onward despatch to GOAT. Surprisingly, I recently had a telephone call from GOAT chasing xParrot's returns to March 2006 (part year) and threatening penalties. On the basis that the 2006 full year returns had already been submitted and approved, I managed to appease the GOAT official. I spoke the same day to Honey Badger, who can find no record of the original returns, and I have now issued duplicates for her.

If I can be of further help, please contact me.

Yours sincerely

Rock Python

Directors : M Parler ~ O Rix ~ R Python ~ N Yarler

E-mail

To Special Projects Technician (GCC) – Ann Teater
<A.Teater@GCC.gov.sf>
From Sales Manager – Paul Cupine <P.Cupine@xParrot.co.sf>
Date 28 May 2007 11.23
Header Sales Analysis

Ann

Further to our meeting, you asked for an analysis of 2006 receipts from sales. I have worked with Honey on this and an analysis is set out below.

| Received | Hardware Resales | Software & Training Resales | PARROT Software | Total |
|-----------|---------------------|-----------------------------------|--------------------|----------------|
| | £ | £ | £ | £ |
| 16-Jan-06 | 0 | 0 | 99,230 | 99,230 |
| 7-Mar-06 | 6,240 | 2,350 | 43,750 | 52,340 |
| 3-Apr-06 | 0 | 4,470 | 49,500 | 53,970 |
| 2-Jun-06 | 23,980 | 2,080 | 48,500 | 74,560 |
| 13-Jul-06 | 39,540 | 9,105 | 61,600 | 110,245 |
| 22-Aug-06 | 37,690 | 12,080 | 55,900 | 105,670 |
| 27-Sep-06 | 47,560 | 8,390 | 62,400 | 118,350 |
| 23-Oct-06 | 35,210 | 9,840 | 61,600 | 106,650 |
| 28-Nov-06 | 37,850 | 9,420 | 32,100 | 79,370 |
| 15-Dec-06 | 2,960 | 6,880 | 48,500 | 58,340 |
| 29-Dec-06 | 1,330 | 6,960 | 3,070 | 11,360 |
| | 232,360 | 71,575 | 566,150 | 870,085 |

I understand that Honey has already completed the sales revenue picture by providing you with details of trade debtors at 31 December 2006. With year-end debtors, 2006 sales income totals £952,235 – in my view a very good result. Having said that, I do expect the 2007 figures to be significantly up on this level and I am currently working on projections for the period June 2007 through to June 2008.

You also asked about trade creditors at 31 December 2006. I apologise for the slowness of my response, but Monty Python handled all invoices and contractual arrangements with clients personally. I am therefore having to search through his and my own records for the information required on contract payments.

However, I can confirm that there were no stocks held at 1 January 2006 and 31 December 2006. All hardware and software bought is ordered specifically for each client.

Paul Cupine

GAMERICHSHIRE MEMORANDUM

TO : Sam Tipeed, Special Projects Officer

FROM : Blake Adder, Director of Technical Services/Acting Managing Director of xParrot

DATE : 29 May 2007

xParrot Limited

Your assistant called asking for information on development costs and on the intention to treat these as capital in the xParrot accounts. In addition to the PARROT rights (IPR) purchased through the £240,000 loan note, it is planned to charge to capital the ongoing development costs of PARROT Version 2 and to amortise these costs over a period still to be agreed. Clearly this will depend upon the estimated life of the core PARROT software and the Development Manager is currently considering this and expects to make a recommendation for tomorrow's Board meeting.

The other development costs to be charged to capital comprise the on-site xParrot Development Manager, Ed Jogg, the contracted input from Cobra Technics over the 5 years and the two staff from my Directorate seconded to xParrot for a 2-year period. The table below details the contracted costs involved (all based upon regular monthly payments) over the first 3-year period, plus the initial purchase cost.

| | 2006 | 2007 | 2008 |
|---------------------|----------------|----------------|----------------|
| | £ | £ | £ |
| PARROT purchase | 240,000 | - | - |
| Development Manager | 40,000 | 40,000 | 40,000 |
| Cobra Technics | 360,000 | 180,000 | 60,000 |
| GCC secondments | 60,000 | 60,000 | - |
| | 700,000 | 280,000 | 100,000 |

The GCC staff costs are fixed for the 2-year secondment period and the Cobra Technics payments are fixed for the 5-year contracted period. All directly-employed xParrot staff have signed 3-year contracts on fixed terms. All these arrangements began from 1st January 2006.

The Phase I computer peripherals upgrade programme was completed in January 2006 at a cost of £78,146. Phase II, which includes essential purchases of upgraded hardware to use for development purposes, is scheduled for June 2007 and Monty Python signed the order for this just before his departure. I will ask the Development Manager to let you have details as this is likely to be a key issue in your proposed cash flow exercise.

On a separate issue, I have recently had discussions with Impala Payroll Services about the fact that we are still paying £90,000 per quarter when actual costs are running at a steady £75,000 per quarter (including agency fee). With some reluctance, Impala has now agreed to make a retrospective repayment in June 2007 for the excess advances paid to the end of that quarter and conceded that future advances should be reduced to £75,000, commencing in July 2007.

Blake Adder

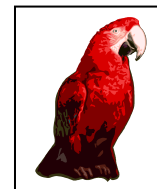
Director of Technical Services and Acting Managing Director of xParrot

Copy –Development Manager, xParrot Limited

xPARROT

MINUTES OF BOARD MEETING

30 MAY 2007



Present : Blake Adder (BA – Acting Managing Director), Ken Cobra (KC – Director), Ryan Oseros (RO – Interim Finance Director), Honey Badger (HB – Secretary)

1. Apologies

BA updated the Board on Mr Python's (MP) absence. He also said that the 2007 elections had only just been held and that these had resulted in a change in power. The new Leader and Deputy had agreed to assume the roles of Non-Executive Directors.

2. Minutes of Board Meeting – 12 January 2007

Noted and agreed.

3. Board responsibilities and membership

BA and RO were confirmed as Acting Managing Director and Interim Finance Director respectively. RO noted that his role would be specific, aimed at finalising the 2006 accounts and evaluating the company's ongoing cash flow position. As a goodwill gesture, no charge would be made by Gumerichshire County Council for this involvement. Sir Leigh Pard and Walter Buffalow had resigned. Jim Pansea and Lily Trotter join the Board.

Resolved : To confirm the appointments on the bases stated.
To accept the resignations of Sir Leigh Pard and Walter Buffalow.

3. Accounts 2006

RO reported good progress, but noted that he required Board confirmation on three issues.

- Write off of the Rift Valley Ventures bad debt (£39,400);
- That the Phase I equipment should be depreciated over 5 years on a straight-line basis;
- That development costs should be amortised over a period of 5 years in line with the expected economic life of the Phase II software.

RO said that once these were determined, the accounts would be finalised and a report brought to the Board. He provisionally suggested 19 June 2007. BA and KC welcomed RO's involvement and asked that the report should also include a critical review of the financial position revealed by the 2006 accounts and how this compared with MP's report on 12 January 2007. In addition, KC expressed concerns about the company's management and financial arrangements under MP. He called for an objective, open and honest appraisal of these issues, so that the Board could decide upon how to address any shortcomings.

Resolved : To confirm the three specific proposals and require the Board report to address the 2006 accounts, their implications and KC's concerns about MP's financial arrangements.

4. Cash Flow

RO commented that MP, through agreement with SHBC, had raised the overdraft limit to £150,000 at the end of March 2007. However, this level too had now been exceeded and discussions with SHBC were ongoing. At the same time, there were other pressures -

- GCC and Cobra Technics – Monies were currently owed to both and the amounts due were now being ascertained. A repayment programme would then need to be agreed.
 - Phase II Equipment – This had been ordered and would require financing in June 2007.
- RO noted that cash flow was likely to be a critical factor for xParrot over the next 12 months or so in terms of its financial viability.

Resolved : To note the issues raised and to ask RO/BA to work closely together in assessing the company's Phase II financing options and its overall medium-term financial prospects.

[END]

Sam Tipeed
Special Projects Officer
County Hall
Gamerich
GA1 1AA

xPARROT
Bush Business Park
Gamerich
GA1 3EF



31 May 2007

Dear Sam,

Firstly, I attach for your information the letter from Kilimanjaro Hardware that sets out details of the agreement for supply of the Phase II hardware upgrade and augmentation programme and the financing option being offered by that company. Whilst not the cheapest, this company does have an international reputation for quality and is a top-class provider.

As I understand it, the other financing options that were being considered by Monty were a bank loan through SHBC to meet all costs and a finance lease through Chameleon Commercial to cover just the equipment costs. I have asked SHBC to let you have details of its terms and I will get Honey to track down the letter from Chameleon Commercial. I have to say that Monty tried to protect us, as managers, from financial matters, so we were not directly involved in these issues. Monty placed all the orders himself and paid the invoices, although I did have to start chasing him in recent months, with a number of our suppliers complaining more and more about late payments and even threatening non-supply.

Secondly, I confirm formally the opinion that I gave to Ryan on the amortisation issue that formed the basis of his statement at the Board meeting concerning the period over which development costs should be amortised. In my view, Version II will take the company through to 2011 (5 years), at which point a Version III is likely to be required. Therefore the 2006 and 2007 development costs should be amortised over 5 years. Any subsequent development expenditure should be amortised over a shorter life to write it off by the end of 2011. I estimate that the majority of the Version I cost is now obsolete and £140,000 should be amortised in 2006, with the balance of Version I cost being written off in 2007.

Development never really stops and hence the need for my role going forward and the ongoing (albeit reduced) payments to Cobra Technics. The two secondments from GCC will not be needed after December 2007 and this is causing some friction – they are far from happy about relinquishing “their” project and have threatened to take their “shabby treatment” further. However, we have more pressing problems at present, as you are aware.

Yours sincerely

Ed Jogg

Development Manager



KILIMANJARO HARDWARE

TANZANIA HOUSE ~ VOLCANO LANE ~ SNOWCAP ~ SNO ING

CHIEF EXECUTIVE ~ RUSSELL VYPER

Mr Monty Python
xParrot Limited
Bush Business Park
Gamerich GA1 3EF

11 April 2007

Dear Monty

Hardware Phase II

Thank you for signing and returning the contract for the supply of the Phase II hardware upgrade and replacement programme. As agreed, delivery is scheduled for 30 June 2007 and I confirm that the costs involved will be fixed as follows –

- o Hardware - £200,000
- o Delivery & Installation - £26,000
- o Maintenance - £10,000 per annum or £40,000 for a 5-year package

Payment for the hardware, delivery and installation costs would be due on 30 June 2007, as would the 5-year package on maintenance, if this is the option chosen. Annual maintenance payments would be due on 30 June each year, commencing 30 June 2007.

You indicated that you would be considering various options to finance these costs, as your cash flow position was unlikely to allow direct funding. We appreciate the difficulty and would be willing to meet all your requirements on the following terms.

- o £65,000 per annum payable for 5 years to cover hardware, delivery, installation and maintenance;
- o Payment annually in arrears with the first payment due on 30 June 2008.

We believe these are extremely competitive terms and, of course, it provides a simple, single-level solution for you with a supplier that you know well.

I look forward to hearing from you.

Yours sincerely

Russell Vyper

Chief Executive

GAMERICHSHIRE MEMORANDUM

TO : Sam Tipeed, Special Projects Officer

FROM : Blake Adder, Director of Technical Services /Acting Managing Director of xParrot

DATE : 1 June 2007

xParrot Limited – xParrot Board Report

To ensure that the statutory deadline is met, I have called a Board meeting for 19 June 2007 to discuss the financial results, but I will need your draft report a week before that. After the figures are agreed, Ryan will draft the statutory accounts based on the management accounts that I want you to draft. Ryan drafted most of the following agreed brief for me.

- ❑ Some brief notes explaining the background to GCC's involvement in the report's production and setting out the objectives of the report as well as the parameters set for it.
- ❑ A critical appraisal of xParrot's management and financial arrangements under Monty Python, covering company structure and management, financial planning, accounting and reporting and financial controls. In particular, please appraise whether xParrot complies with the relevant sections of the Safariland Combined Code of Corporate Governance;
- ❑ Presentation of the xParrot Profit and Loss Account (in management accounting format but showing profit before interest and tax and profit before tax) for the year ending 31 December 2006, including computation of the BIRD tax liability for 2006;
- ❑ Presentation of the xParrot Balance Sheet as at 31 December 2006;
- ❑ A critical appraisal of the accounts produced and the limitations in evaluating these.

Ann Teater has already written up the Cash Book for items on the bank statement up to 31 December 2006, but I want you to complete it for all relevant items. The receipts and payments analyses in respect of the items on the bank statement are attached.

Production of the accounts will involve the following steps, and I would like you to submit the relevant schedules along with the accounts for my information:

- ❑ An analysed summary of cash advances and payments on the Disbursements Account reconciled to the cash and cash equivalents in hand at 31 December 2006;
- ❑ Completion of the analysed Cash Book for the year ending 31 December 2006, using the agreed pro formas, and its reconciliation to the bank balance at 31 December 2006.
- ❑ Adjustment of the 2006 analysed Cash Book through –
 - An analysis of payroll agency advances and costs for 2006 to separate pay from travel and subsistence payments and capital (development costs) from revenue charges as well as the identification of the payment in advance made to Impala Payroll Services;
 - An analysis of 2006 non-revenue expenditure;
- ❑ Conversion of the 2006 analysed Cash Book (revenue receipts and revenue payments) onto an accruals basis and collation of 2006 capital payments on an accruals basis.

In addition, for the new Board members, please also include in the report an explanation and commentary on –

- ❑ Why the information about liquidity presented to the Board meeting of 12 January 2007 was so inaccurate and misleading about the company's true year end liquidity position;
- ❑ The reason for accruals accounting rather than a cash receipts and payments basis;
- ❑ The treatment of capital items in the accounts and why this differs from revenue.

I look forward to reading your draft report.

*Blake Adder*Director of Technical Services and Acting Managing Director of xParrot**Cash Book 2006 - Receipts Analysis**

| | Total | Hardware Resales | Software Resales | Software Own | Rent Sub-let | Share Capital |
|-----------|------------|---------------------|---------------------|-----------------|-----------------|------------------|
| | £ | £ | £ | £ | £ | £ |
| 16-Jan-06 | 99,530.00 | 0.00 | 0.00 | 99,230.00 | 0.00 | 300.00 |
| 7-Mar-06 | 52,340.00 | 6,240.00 | 2,350.00 | 43,750.00 | 0.00 | 0.00 |
| 3-Apr-06 | 53,970.00 | 0.00 | 4,470.00 | 49,500.00 | 0.00 | 0.00 |
| 2-Jun-06 | 74,560.00 | 23,980.00 | 2,080.00 | 48,500.00 | 0.00 | 0.00 |
| 13-Jul-06 | 110,245.00 | 39,540.00 | 9,105.00 | 61,600.00 | 0.00 | 0.00 |
| 22-Aug-06 | 105,670.00 | 37,690.00 | 12,080.00 | 55,900.00 | 0.00 | 0.00 |
| 27-Sep-06 | 119,350.00 | 47,560.00 | 8,390.00 | 62,400.00 | 1,000.00 | 0.00 |
| 23-Oct-06 | 106,650.00 | 35,210.00 | 9,840.00 | 61,600.00 | 0.00 | 0.00 |
| 8-Nov-06 | 500.00 | 0.00 | 0.00 | 0.00 | 500.00 | 0.00 |
| 28-Nov-06 | 79,370.00 | 37,850.00 | 9,420.00 | 32,100.00 | 0.00 | 0.00 |
| 15-Dec-06 | 58,340.00 | 2,960.00 | 6,880.00 | 48,500.00 | 0.00 | 0.00 |
| | 860,525.00 | 231,030.00 | 64,615.00 | 563,080.00 | 1,500.00 | 300.00 |

Cash Book 2006 - Payments Analysis

| | Total | Direct Costs | Payroll | Premises | Travel & Subsistence | Office Equipment | Office Expenses | Gifts & Hospitality | Exhibitions & Promotions | Miscellaneous | Non-Revenue |
|-----------|------------|--------------|------------|-----------|----------------------|------------------|-----------------|---------------------|--------------------------|---------------|-------------|
| | £ | £ | £ | £ | £ | £ | £ | £ | £ | £ | £ |
| 2-Jan-06 | 5,000.00 | | | | | | | | | | 5,000.00 |
| 13-Jan-06 | 90,000.00 | | 90,000.00 | | | | | | | | |
| 16-Jan-06 | 78,146.00 | | | | | | | | | | 78,146.00 |
| 17-Jan-06 | 22,500.00 | 22,500.00 | | | | | | | | | |
| 31-Mar-06 | 4,058.16 | | | | | | | | | | |
| 3-Apr-06 | 9,864.00 | 9,864.00 | | | | | | | | | |
| 3-Apr-06 | 4,987.48 | | | 4,987.48 | | | | | | | |
| 14-Apr-06 | 90,000.00 | | 90,000.00 | | | | | | | | |
| 5-Jun-06 | 32,350.00 | 32,350.00 | | | | | | | | | |
| 5-Jun-06 | 10,042.00 | 10,042.00 | | | | | | | | | |
| 30-Jun-06 | 3,551.82 | | | | | | | | | | |
| 3-Jul-06 | 3,560.98 | | | | | | | | | | |
| 6-Jul-06 | 10,000.00 | | | | | | | | | | |
| 13-Jul-06 | 15,000.00 | | | | | | | | | | |
| 13-Jul-06 | 90,000.00 | | 90,000.00 | | | | | | | | |
| 18-Jul-06 | 5,672.31 | | | 5,672.31 | | | | | | | |
| 26-Jul-06 | 6,745.89 | | | | | | | | | | |
| 22-Aug-06 | 51,893.00 | 51,893.00 | | | | | | | | | |
| 23-Aug-06 | 15,000.00 | | | | | | | | | | |
| 6-Sep-06 | 5,000.00 | | | 5,000.00 | | | | | | | |
| 14-Sep-06 | 15,998.00 | 15,998.00 | | | | | | | | | |
| 27-Sep-06 | 25,800.00 | | | | | | | | 25,800.00 | | |
| 27-Sep-06 | 20,000.00 | | | | | | | | | | |
| 29-Sep-06 | 4,825.77 | | | | | | | | | | |
| 10-Oct-06 | 4,672.49 | | | 4,672.49 | | | | | | | |
| 12-Oct-06 | 90,000.00 | | 90,000.00 | | | | | | | | |
| 23-Oct-06 | 58,794.00 | 58,794.00 | | | | | | | | | |
| 26-Oct-06 | 20,000.00 | | | | | | | | | | |
| 7-Nov-06 | 7,981.45 | 7,981.45 | | | | | | | | | |
| 8-Nov-06 | 2,951.56 | | | | | | | | | | |
| 22-Nov-06 | 6,179.00 | 6,179.00 | | | | | | | | | |
| | 810,573.91 | 215,601.45 | 360,000.00 | 20,332.28 | 0.00 | 3,131.94 | 11,515.22 | 3,427.56 | 25,800.00 | 7,619.46 | 163,146.00 |



The Acting Managing Director
 xParrot Limited
 Bush Business Park
 Gamerich
 GA1 3EF

4 June 2007

Dear Mr Adder,

Further to the enquiry received via Ann Teater, I set out below a summary of the invoices raised and despatched to xParrot Limited for goods and services provided to the end of May 2007.

| | Second- ments £ | Leased Cars £ | County Supplies £ | Total £ |
|-----------------------|-----------------------|---------------------|-------------------------|----------------|
| 01-Jan to 31-Dec 2006 | 60,000 | 27,840 | 8,160 | 96,000 |
| 01-Jan to 31-May 2007 | 25,000 | 11,600 | 3,400 | 40,000 |
| | 85,000 | 39,440 | 11,560 | 136,000 |

To date, no payments have been received in respect of these invoices.

You should be aware that reminders were sent to Mr Python on a regular basis until mid-2006, but without response. I then referred the matter to the County Treasurer (now retired) and, because of xParrot's close connections with the County Council, I was told not to initiate enforcement action.

You also asked about settlement terms. On the assumption that the full amount cannot be met immediately, the Council's normal practice would be to seek an immediate lump sum plus settlement of the balance by equal instalments over the next 12 months. A lump sum of £40,000 payable in June 2007 plus 12 instalments of £8,000 commencing in July 2007 would probably be acceptable.

Under such an agreement, there would also be a requirement for all new invoices to be settled promptly commencing in June 2007 (for forward cash flow planning, this averages £8,000 per month).

Yours sincerely

Pippa Strell

Head of Income

Copy – Ann Teater (Special Projects Technician)



Safari & Hunting Banking Corp

“tracking down the right terms for you”

The Acting Managing Director
xParrot Limited
Bush Business Park
Gamerich GA1 3EF

5 June 2007

Dear Mr Adder

Account 10056659

Thank you for keeping me informed of the changed circumstances. I have given considerable thought to the current xParrot Limited overdraft situation.

I was pleased to offer xParrot banking and overdraft facilities some 18 months ago, largely on the basis of its strong links with Gamerichshire County Council (GCC) for whom SHBC has acted as bankers since the early 1990s. The initial overdraft of £100,000 agreed would normally have been subject to more stringent scrutiny in terms of business plans etc. and less favourable terms. However, my understanding with the former County Treasurer was that GCC was informally acting as guarantor. This understanding and goodwill was continued when XParrot sought to increase its overdraft to £150,000 in March. At the time, I was assured that this was likely to be a temporary increase pending the launch of PARROT Version 2 and the increased revenues that would flow from this launch. Again, the explanation and assurances were accepted on the basis of your company's firm GCC connections.

Whilst the banking facilities contract with GCC remains important to SHBC and I do not want to do anything to sour that relationship, I am becoming increasingly concerned about your company's unsatisfactory cash flow position. As you know, the overdraft at the end of April and May was in excess of £150,000, a level at which I would have immediately withdrawn the bank's commitment in normal circumstances.

SHBC is no longer prepared to continue on the present basis. The bank takes the view that the company should be refinanced to eliminate the overdraft or that any overdraft facility must be guaranteed by GCC. I give notice that, unless I hear from you within the next week with a satisfactory response to these proposals, the current overdraft facility (which is repayable on demand) will be terminated at once and legal action to apply for a winding up order against the company will be initiated to recover the outstanding liability.

On a separate yet related issue, your Development Manager asked about loan facilities for the purchase, installation and maintenance of equipment to be acquired at 30 June 2007. On the assumption that the overdraft is cleared or guaranteed by GCC, the terms would be -

- As requested, an advance of £266,000 to cover purchase, installation and maintenance (5-year package option);
- Five equal repayments of principal with the first payment due on 30 June 2008;
- An interest rate of 6.5% payable on the balance outstanding at 30 June annually (before principal repayment), commencing 30 June 2008;
- An arrangement fee of £5,000 payable on 30 June 2007.

I look forward to receiving the assurances required.

Yours sincerely

O Kapi
Manager

SHBC ~ Gamerich Branch ~ Thorn Tree Avenue ~ Gamerich ~ GA1 4DE

Sam Tipeed
Special Projects Officer
County Hall
Gamerich
GA1 1AA

xPARROT
Bush Business Park
Gamerich
GA1 3EF



6 June 2007

Dear Sam,

Further to your enquiry, I can confirm that xParrot does not have a mission statement or any stated corporate objectives. Mr Python had no time for such ideas and spent most of his time on sales and marketing. He was rarely here and did not like "wasting time talking in the office".

On income, please note that the end December and end March quarters sub-let rents were never received. Mr Python's brother has now left the country, so you should assume that this will not now be paid.

On cash flows, I am pleased to report that I have made good progress. I have now finalised the cash flow statements on an actual basis through to the end of May 2007 in the format agreed with you and have reconciled them back to the latest bank statement. Please note that the December 2006 quarter invoices from GNU Utilities (£5,432.11) and Bushcom Telephones (£3,323.70) were paid in January 2007.

The Acting Managing Director considers that the period to 30 June 2008 is likely to be tight financially. He has requested me to set down details of all the expected cash movements for the period 1 January 2007 to 30 June 2008 that I know about. He has asked me to show sales receipts net of direct cost payments (bought-in hardware, software etc.), as the Sales Manager has indicated that he will produce his projections on this basis. I will also assume that ongoing payments to GCC and Cobra recommence in June 2007 at agreed levels. There will be more cash payments and receipts, but you will have to take account of them as the relevant information becomes available.

I have also managed to find in one of Mr Python's drawers the finance lease quotation from Chameleon Commercial that the Development Manager mentioned to you (see attached). Mr Python dealt with all contractual matters himself. As you can see, this letter came in before the final quotation from Kilimanjaro Hardware.

You should also be aware that we have had a visit from the local press, asking a lot of questions about the xParrot operation and its finances, in particular. They seemed to know quite a lot and were quoting a source "within the Council" from what they said. Paul Cupine, the Sales Manager, was the only manager in the office and he dealt with their questions, although I did see them afterwards talking to the staff seconded from GCC.

Yours sincerely

Honey Badger

Sam

I have reconciled Honey's figures up to May to the bank statements and verified her analysis - correct as usual.

Ann

CHAMELEON COMMERCIAL

“forever adapting to match your needs”



Mr M Python
xParrot Limited
Bush Business Park
Gamerich
GA1 3EF

21 March 2007

Dear Mr Python

Computer Equipment

It was useful to discuss your financing needs when I telephoned today.

I understand from you that you are soon to complete your Phase II computer upgrade programme and that external financing is likely to be required for the capital purchase plus installation and possibly ongoing maintenance. As explained, Chameleon can only finance physical assets so you would have to fund installation (including operating system software) and maintenance costs from revenue or an alternative source. You explained that the final quotation by the hardware company was still awaited, but that the computer capital cost was likely to be in the range £150,000-£250,000.

Chameleon Commercial is delighted to be able to offer the following very competitive terms (subject to contractual formalities being completed by 30 June 2007).

- *A 5-year finance lease for the cost of the capital equipment only (not including installation and maintenance) commencing on 1 July 2007;*
- *Based upon a 6% per annum interest rate;*
- *Repayable by 5 equal annual instalments (principal and interest combined);*
- *With the first instalment payable on 30 June 2008.*

Once you know the capital sum, you will be able to calculate the annual instalments.

I hope very much that you will find these terms acceptable and that we can assist you with your development plans.

Yours sincerely

Ken Melian

Account Manager

Branch HQ ~ Treetop House ~ Rainforest ~ Gamerichshire ~ RF2 1DZ

E-mail

To Special Projects Officer (GCC) – Sam Tipeed
<S.Tipeed@GCC.gov.sf>
From Sales Manager – Paul Cupine <P.Cupine@xParrot.co.sf>
CC Secretary – Honey Badger <H.Badger@xParrot.co.sf>
Date 7 June 2007 15.39
Header Sales Projections

Sam

I have now completed my creditors exercise. On direct costs, payments totalled £255,421.45 in 2006 and there were two creditors as follows which relate to 2006 but were paid in 2007:

- Tarzantec – hardware for resale - £38,390
- Serengeti – software/training for resale - £4,700

On overheads, there was one invoice outstanding as follows.

- Pink Panther – promotions/exhibitions - £17,830

As requested, I also set out below my projections for net receipts in the coming months. The figures in the table below show projected sales receipts in each month reduced by the estimated amount of direct payments (bought in hardware, software, manuals etc.) made in that month. I have the breakdown should you require it, but the net figures are sufficient for your cash flow exercise.

| 2007 | £ ¹ | 2007 | £ | 2008 | £ |
|----------------------|----------------|--------------|----------------|--------------|----------------|
| January ² | 78,710 | July | 66,000 | January | 128,000 |
| February | 90,350 | August | 73,000 | February | 48,000 |
| March | 40,620 | September | 74,000 | March | 62,000 |
| April | 80,600 | October | 81,000 | April | 83,000 |
| May | 30,480 | November | 106,000 | May | 77,000 |
| June | 97,000 | December | 47,000 | June | 57,000 |
| Total | 417,760 | Total | 447,000 | Total | 455,000 |

¹ Confirmed cash flows per Honey Badger, but see note ²

² Cash flow projection is £50,250 = £78,710 - £39,820 (2006 payment)+ £11,360 (2006 receipt)

Most of these figures reflect current contracts, but I have built into the figures my estimate of additional net receipts from potential new clients. This amounts to about 25% of the net total projections. This does not seem unreasonable to me in view of the imminent Version 2 launch, but the amounts involved are, of course, unsecured at present. I also expect net receipts in the second half of 2008 to be £80,000 higher than in the equivalent period in 2007. Despite their persistent questions about falling sales levels, I did not share any of these figures with the press.

On the negative side, you should provide £30,000 for Exhibitions in November 2007 and £15,000 in January 2008. You have to speculate to accumulate!

Paul

GAMERICHSHIRE MEMORANDUM

TO : Sam Tipeed, Special Projects Officer
FROM : Ryan Oseros, Head of Financial Services/Interim Finance Director of xParrot
DATE : 8 June 2007

xParrot Limited – Cash Flow & Capital Financing Options

In view of the recent letter from SHBC, it seems clear that the GCC Chief Executive and Leader must provide assurances about the ongoing viability of xParrot Limited. Related to this is the need to finance the Phase II computer upgrade at the end of the month. It has become clear that the company needs an urgent injection of capital. GCC is not prepared to finance this on its own. It has therefore been agreed by the three investors that they will each subscribe for a further £59,900 £1 shares at par, bringing their shareholdings up to £60,000 each. Monty Python has been contacted at his retreat on St. Parfit and he has reluctantly agreed to subscribe to the capital injection. The company will continue with the arrangements to clear other forms of indebtedness to the investors on the basis already agreed.

As regards the financing of the Phase II computer upgrade, outright payment from revenue for the whole of the Phase II hardware, delivery and installation is clearly unwise given the liquidity situation and I have now agreed with Blake Adder that three options will be considered as follows to finance this development (this finance is needed before the end of June):–

- The Chameleon Commercial finance lease with installation/maintenance met from revenue;
- The bank loan through SHBC, with the arrangement fee met from revenue;
- The 5-year package deal offered by Kilimanjaro Hardware.

These should all be evaluated on the basis of the terms and conditions in the letters received. Whilst the offer from Chameleon Commercial does appear very competitive indeed, although unlike the other companies involved it does not have an established track record.

An appraisal of the three options is required in the context of forward projections of xParrot's cash flows. A review of xParrot's performance in managing cash flow under Monty Python's leadership is also needed so that I can respond to any questions from the new Leader. To this end I asked Honey Badger to finalise the cash flow projection exercise that she was undertaking. This is attached. In view of the urgency of regularising the liquidity position, I have reviewed the analysis of cash movements up to date and the monthly cash flow projection up to 30th June 2008. As usual, the standard of her work is high and the projections appear to be arithmetically sound on the basis of the assumptions made. I instructed her to assume a cash book position of £46,000 overdrawn as the starting point at the beginning of January 2007. This is made up of £51,000 overdrawn on the current account plus £5,000 cash float (Disbursements Account) balance. I see no reason to maintain the separate cash float in future, and I have instructed Honey Badger to prepare the cash flow analysis and cash flow projection on the assumption that all liquid funds are pooled in the current account, and for consistency to merge the current account and cash float balances for the periods January to May 2007 inclusive. I also assumed BIRD liability for 2006 and 2007 as £6,500 and £9,500 respectively. Your exercise on the 2006 accounts will give us the exact position, but hopefully my estimates will be close to your figures and using my estimates has allowed the immediate production of the cash flow projection. For the sake of consistency use the figures in the cash flow projection as drafted; do not restate the position in the light of your precise figures for the closing December 2006 cash position or 2006 BIRD liability.

The Leader is keen to repair relationships with SHBC and it has been decided to clear the overdraft and in future xParrot must remain cash positive at all times. The level of the capital injection is intended to allow xParrot to trade without any liquidity crises. Although cash flows are volatile, going forward there should be surplus funds at least some of the time. Rather than leave short-term surplus funds in the current account earning little or no interest, they will be invested short-term by money brokers. The brokers will charge a fee of £15 for any transfer in or out of their investment fund. They expect to earn a return of 4.75% per annum which equates to a daily return of 0.00012715 (or 0.012715%). The current account pays no interest on credit balances.

The new policy is to maintain a minimum balance of £8,000 in the current account. Please use the Miller-Orr model to determine the upper limit of the current account balance and the target level. The movements on net daily bank balances for the two month period from mid-September to mid-November 2006 may be taken as representative of the volatility of daily cash flows. This analysis has been prepared by Honey Badger and is attached.

Please draft a Board report for my review that covers the following:

- A brief note of the purpose of the liquidity review and consideration of financing of the investment, the guidelines and assumptions applied, the capital financing options considered and the criteria set for their appraisal;
- A critical evaluation of xParrot's approach to cash flow management in the period since incorporation to Mr Python's departure on sick leave (including trade debtor recovery and creditor payment periods for 2006);
- An appraisal of the position revealed by the attached cash flow analysis to June 2007 and the cash flow projection up to June 2008 and the risks and uncertainties to which it is subject;
- Computation and explanation of Miller-Orr cash management parameters (the upper limit for the current account balance and the target level) together with an explanation of the meaning of the concepts of upper and lower limits and target level and how they will be applied in future cash management arrangements. For the sake of simplicity, do not attempt to estimate any interest receivable nor should you adjust the cash flow projection projections for any interest payable;
- Appraisal of the revenue implications of the three capital financing options on an actual and discounted basis (use 2007 as the base year and a 5% discount rate) over the period 2007 to 2012;
- An evaluation of the results of this exercise and a summary assessment of the possible impact of the development on the projected future liquidity as at June 2007 and June 2008 (ignore any effect on overdraft interest);
- A recommendation as to the preferred financing option with supporting rationale. The preferred option should be the cheapest and/or the one that best fits xParrot's projected cash flow profile.

In evaluating the different Phase II financing scenarios and their impact on cash flows, please bear in mind the policy that the minimum cash limit of £8,000 should always be maintained. Is this policy realistic and is there evidence of the liquidity position improving in 2008?

Ryan Oseros

Head of Financial Services and Interim Finance Director of xParrot

xParrot Limited**Cash Flow - 9 months to 30 September 2007**

| | | Jan-07 | Feb-07 | Mar-07 | Apr-07 | May-07 | Jun-07 | Jul-07 | Aug-07 | Sep-07 |
|-------------------------------|---------------|-----------------|-----------------|------------------|------------------|------------------|------------------|-----------------|---------------|---------------|
| | | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Sales receipts | | 50.250 | 90.350 | 40.620 | 80.600 | 30.480 | 97.000 | 66.000 | 73.000 | 74.000 |
| Capital injection | | | | | | | 179.700 | | | |
| | | 50.250 | 90.350 | 40.620 | 80.600 | 30.480 | 276.700 | 66.000 | 73.000 | 74.000 |
| Pay | Agency | | 90.000 | | 90.000 | | (90.000) | 75.000 | | |
| | GCC ongoing | | | | | | 8.000 | 8.000 | 8.000 | 8.000 |
| | GCC arrears | | | | | | 40.000 | 8.000 | 8.000 | 8.000 |
| Contracted Services | Cobra ongoing | 50.000 | | 50.000 | 15.000 | 30.000 | 15.000 | 15.000 | 15.000 | 15.000 |
| | Cobra arrears | | | | | | 40.000 | 15.000 | 15.000 | 15.000 |
| Premises | Rent | | | | 5.000 | | 10.000 | | | |
| | Utilities | 5.432 | | | 5.510 | | | 5.500 | | |
| Office Equipment | | 1.039 | | 0.988 | | | 1.000 | | | 1.000 |
| Office Expenses | Telephones | 3.324 | | | 3.170 | | | 3.300 | | |
| | | 0.519 | | 0.645 | | | 0.600 | | | 0.600 |
| Gifts/hospitality | | 1.094 | | 1.232 | | | 1.100 | | | 1.100 |
| Exhibitions & Promotions | | 34.730 | | | | | | | | |
| Miscellaneous | | 1.349 | | 1.286 | | | 1.300 | | | 1.300 |
| BIRD Liability | | | | 6.500 | | | | | | |
| GCC Loan Note | Repayment | | | 10.000 | | | 10.000 | | | |
| Bank Charges & Interest | | | | | | | 3.610 | | | |
| | | 97.487 | 90.000 | 70.651 | 118.680 | 30.000 | 40.610 | 129.800 | 46.000 | 50.000 |
| Net Cash Flow | | (47.237) | 0.350 | (30.031) | (38.080) | 0.480 | 236.090 | (63.800) | 27.000 | 24.000 |
| Cash and cash equivalents b/f | | (46.000) | (93.237) | (92.887) | (122.918) | (160.998) | (160.518) | 75.572 | 11.772 | 38.772 |
| Cash and cash equivalents c/f | | (93.237) | (92.887) | (122.918) | (160.998) | (160.518) | 75.572 | 11.772 | 38.772 | 62.772 |

Cash Flow - 9 months to 30 June 2008

| | | Oct-07 | Nov-07 | Dec-07 | Jan-08 | Feb-08 | Mar-08 | Apr-08 | May-08 | Jun-08 |
|--------------------------|---------------|-----------------|----------------|-----------------|----------------|---------------|---------------|-----------------|---------------|----------------|
| | | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Sales receipts | | 81.000 | 106.000 | 47.000 | 128.000 | 48.000 | 62.000 | 83.000 | 77.000 | 57.000 |
| Pay | Agency | 75.000 | | | 75.000 | | | 75.000 | | |
| | GCC ongoing | 8.000 | 8.000 | 8.000 | 3.000 | 3.000 | 3.000 | 3.000 | 3.000 | 3.000 |
| | GCC arrears | 8.000 | 8.000 | 8.000 | 8.000 | 8.000 | 8.000 | 8.000 | 8.000 | 8.000 |
| Contracted Services | Cobra ongoing | 15.000 | 15.000 | 15.000 | 5.000 | 5.000 | 5.000 | 5.000 | 5.000 | 5.000 |
| | Cobra arrears | 15.000 | 15.000 | 15.000 | 15.000 | 15.000 | 15.000 | 15.000 | 15.000 | 15.000 |
| Premises | Rent | | | 10.000 | | | | | | 15.000 |
| | Utilities | 5.500 | | | 5.500 | | | 5.500 | | |
| Office Equipment | | | | 1.000 | | | 1.000 | | | 1.000 |
| Office Expenses | Telephones | 3.300 | | | 3.300 | | | 3.300 | | |
| | | | | 0.600 | | | 0.600 | | | 0.600 |
| Gifts/hospitality | | | | 1.100 | | | 1.100 | | | 1.100 |
| Exhibitions & Promotions | | | 30.000 | | 15.000 | | | | | |
| Miscellaneous | | | | 1.300 | | | 1.300 | | | 1.300 |
| BIRD Liability | | | | 9.500 | | | | | | |
| GCC Loan Note | Repayment | | | 10.000 | | | | | | 10.000 |
| Bank Charges & Interest | | | | 0.600 | | | | | | 0.600 |
| | | 129.800 | 76.000 | 80.100 | 129.800 | 31.000 | 35.000 | 114.800 | 31.000 | 60.600 |
| Net Cash Flow | | (48.800) | 30.000 | (33.100) | (1.800) | 17.000 | 27.000 | (31.800) | 46.000 | (3.600) |
| Balance b/f | | 62.772 | 13.972 | 43.972 | 10.872 | 9.072 | 26.072 | 53.072 | 21.272 | 67.272 |
| Balance c/f | | 13.972 | 43.972 | 10.872 | 9.072 | 26.072 | 53.072 | 21.272 | 67.272 | 63.672 |

xParrot Limited**Analysis of Daily Bank Balances - Representative Period**

| <u>Date</u> | Balance | Movement (X) | X - μ | (X - μ)² |
|--------------------|----------------|---------------------|-----------------------------|---|
| | £'000 | £'000 | £'000 | £'000 |
| 13/09/2006 | (57.057) | 0.000 | 0.569 | 0.323 |
| 14/09/2006 | (73.055) | (15.998) | (15.429) | 238.063 |
| 15/09/2006 | (73.055) | 0.000 | 0.569 | 0.323 |
| 18/09/2006 | (73.055) | 0.000 | 0.569 | 0.323 |
| 19/09/2006 | (73.055) | 0.000 | 0.569 | 0.323 |
| 20/09/2006 | (73.055) | 0.000 | 0.569 | 0.323 |
| 21/09/2006 | (73.055) | 0.000 | 0.569 | 0.323 |
| 22/09/2006 | (73.055) | 0.000 | 0.569 | 0.323 |
| 25/09/2006 | (73.055) | 0.000 | 0.569 | 0.323 |
| 26/09/2006 | (73.055) | 0.000 | 0.569 | 0.323 |
| 27/09/2006 | 0.495 | 73.550 | 74.119 | 5,493.583 |
| 28/09/2006 | 0.495 | 0.000 | 0.569 | 0.323 |
| 29/09/2006 | (4.330) | (4.826) | (4.257) | 18.123 |
| 02/10/2006 | (4.330) | 0.000 | 0.569 | 0.323 |
| 03/10/2006 | (4.330) | 0.000 | 0.569 | 0.323 |
| 04/10/2006 | (4.330) | 0.000 | 0.569 | 0.323 |
| 05/10/2006 | (4.330) | 0.000 | 0.569 | 0.323 |
| 06/10/2006 | (4.330) | 0.000 | 0.569 | 0.323 |
| 09/10/2006 | (4.330) | 0.000 | 0.569 | 0.323 |
| 10/10/2006 | (9.003) | (4.672) | (4.104) | 16.841 |
| 11/10/2006 | (9.003) | 0.000 | 0.569 | 0.323 |
| 12/10/2006 | (99.003) | (90.000) | (89.431) | 7,997.956 |
| 13/10/2006 | (99.003) | 0.000 | 0.569 | 0.323 |
| 16/10/2006 | (99.003) | 0.000 | 0.569 | 0.323 |
| 17/10/2006 | (99.003) | 0.000 | 0.569 | 0.323 |
| 18/10/2006 | (99.003) | 0.000 | 0.569 | 0.323 |
| 19/10/2006 | (99.003) | 0.000 | 0.569 | 0.323 |
| 20/10/2006 | (99.003) | 0.000 | 0.569 | 0.323 |
| 23/10/2006 | (51.147) | 47.856 | 48.425 | 2,344.953 |
| 24/10/2006 | (51.147) | 0.000 | 0.569 | 0.323 |
| 25/10/2006 | (51.147) | 0.000 | 0.569 | 0.323 |
| 26/10/2006 | (71.147) | (20.000) | (19.431) | 377.575 |
| 27/10/2006 | (71.147) | 0.000 | 0.569 | 0.323 |
| 30/10/2006 | (71.147) | 0.000 | 0.569 | 0.323 |
| 31/10/2006 | (71.147) | 0.000 | 0.569 | 0.323 |
| 01/11/2006 | (71.147) | 0.000 | 0.569 | 0.323 |
| 02/11/2006 | (71.147) | 0.000 | 0.569 | 0.323 |
| 03/11/2006 | (71.147) | 0.000 | 0.569 | 0.323 |
| 06/11/2006 | (71.147) | 0.000 | 0.569 | 0.323 |
| 07/11/2006 | (79.128) | (7.981) | (7.413) | 54.949 |
| 08/11/2006 | (82.080) | (2.952) | (2.383) | 5.678 |
| 09/11/2006 | (82.080) | 0.000 | 0.569 | 0.323 |
| 10/11/2006 | (82.080) | 0.000 | 0.569 | 0.323 |
| 13/11/2006 | (82.080) | 0.000 | 0.569 | 0.323 |
| | | <u>(25.023)</u> | | <u>16,559.026</u> |

$$\text{Mean } \mu = \frac{\sum X}{N} = \frac{(25.023)}{44} = (0.569)$$



COBRA TECHNICS

KING COBRA HOUSE ~ VENOM LANE ~ NEW FANGHI ~ INDIA

The Acting Managing Director
xParrot Limited
Bush Business Park
Gamerich
GA1 3EF

11 June 2007

Dear Blake

Further to our telephone conversation, I confirm my agreement to your proposal about the arrears due to both Gamerichshire County Council (GCC) and Cobra Technics, namely –

- An immediate payment of £40,000 to both GCC and Cobra Technics payable on 1 June 2007;
- The balance of any arrears (to 31 May 2007) to be repaid through 12 equal instalments over the period July 2007 to June 2008, with the first payment on 1 July 2007.

This appears both equitable and manageable, but is conditional upon the normal ongoing payments being paid in full and on time to both parties, commencing in June 2007.

I calculate the total arrears due to Cobra Technics at the end of May 2007 to be £220,000 (£435,000 due less £215,000 paid).

It is also perhaps worth putting in writing that, whilst I clearly have concerns about the current situation, I remain totally committed to the ongoing development of PARROT and to my role as a director of xParrot Limited. I have no doubt that Version 2 is ahead of the market and will be a real winner.

Best regards

Ken Cobra

Chief Executive Officer