Creative Scotland

Annual Report to the Board and the Auditor General for Scotland 2010/11

September 2011

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Executive Summary

Creative Scotland became a Statutory Non Departmental Public Body (NDPB) on 1 July 2010, under the Public Services Reform (Scotland) Act. It replaces the Scottish Arts Council and Scottish Screen and has been established a single body responsible for overseeing Scotland's arts and culture sector. Both lottery funds' (SAC NLDF and SSNLDF) powers as a National Lottery Fund Distributor have been transferred to Creative Scotland under the National Lottery etc. Act 1993 (Amendment of Section 23) (Creative Scotland) Order 2010.

Financial Statements

Our audit of the 2010/11 financial statements for Creative Scotland and Creative Scotland National Lottery Distribution Fund is complete and our audit opinion is unqualified on both sets of financial statements.

We have also concluded that in all material respects, the expenditure and receipts shown in both sets of financial statements were incurred or applied in accordance with applicable enactments and relevant guidance issued by Scottish Ministers.

Use of Resources

Creative Scotland incurred expenditure of £58.132m in 2010/11 (2009/10: £59.229m) and received income of £54.925m (2009/10: £58.763m) including grant-in-aid funding of £51.577m from the Scottish Government. Taking into account recognised gains and losses the overall effect was a decrease in the Creative Scotland reserves of £2.770m.

Creative Scotland NLDF incurred expenditure of £14.153 m in 2010/11 (2009/10: £24.253 m) and received income of £23.920m (2009/10: £22.818m) including National Lottery Fund proceeds of £22.892m. The net impact was an increase in the in the general fund of £9.767m.

Performance

A joint corporate plan for 2010/11 was prepared by the Scottish Arts Council and Scottish Screen which covered both joint working and individual plans for the legacy organisations. This plan has been inherited by Creative Scotland at 1 July 2010. The main focus for Creative Scotland in 2010/11 was to ensure no detrimental impact on supported sectors by committing to continue to manage the inherited programmes.

Creative Scotland published its 2011-2014 corporate plan in March 2011. A series of road shows were held to launch the plan during April 2011. Overall Creative Scotland believes the plan has been well received. Creative Scotland however has yet to develop a performance management framework. Plans are in place to develop a framework over the coming months.

Governance

The Creative Scotland Board of Directors was appointed on the 1 July 2010 and currently comprises nine non-executive directors. Formal induction arrangements were established for the Board and work is ongoing to assess the skills mix of the board to ensure it has the right skills, knowledge and experience. The Board has met on a regular basis since July 2010 and has been actively involved in the development and approval of the key strategic documents for Creative Scotland, including the 2011-2014 corporate plan. The Board has delegated certain matters to sub-committees, including an audit and risk committee and remuneration committee. To date these committees have met in accordance with the terms of reference.

Creative Scotland has recently developed its risk management arrangements. Over the coming year it will be essential that these arrangements are fully embedded across the organisation. The audit and risk committee has delegated responsibility for the review of risk management arrangements at Creative Scotland. It is important however that the whole board also consider risk and any preventative action that can be taken.

Conclusion

This report concludes the 2010/11 audit of the Creative Scotland and Creative Scotland National Lottery Distribution Fund. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

This report has been discussed and agreed with the Creative Scotland Director of Finance and Operations. We would like to thank all management and staff for their co-operation and assistance during our audit.

Scott-Moncrieff
September 2011

Introduction

1. Creative Scotland became a Statutory Non Departmental Public Body (NDPB) on 1 July 2010, under the Public Services Reform (Scotland) Act. It replaces the Scottish Arts Council and Scottish Screen and has been established a single body responsible for overseeing Scotland's arts and culture sector. Both lottery funds' (SAC NLDF and SSNLDF) powers as a National Lottery Fund Distributor have been transferred to Creative Scotland under the National Lottery etc Act 1993 (Amendment of Section 23) (Creative Scotland) Order 2010.

2. The Auditor General for Scotland is the Scottish Parliament's watchdog for ensuring propriety and value for money in the spending of public monies. The Auditor General for Scotland is responsible for securing the audit of the Scottish Government and most public bodies, including central government bodies, in Scotland.

3. The Auditor General for Scotland has appointed Scott-Moncrieff as external auditor of Creative Scotland Non-Departmental Public Body and the Creative Scotland National Lottery Distribution Fund for 2010/11. Scott-Moncrieff was previously appointed as external auditor of Scottish Arts Council, Scottish Arts Council National Lottery Distribution Fund and Scottish Screen National Lottery Distribution Fund for the period 2006/07-2009/10.

4. This report summarises the findings from our 2010/11 audit of Creative Scotland and Creative Scotland National Lottery Distribution Fund (NLDF). The scope of our audit was set out in our External Audit Annual Plan, which was presented to the Creative Scotland Audit Committee in December 2010.

5. The Code of Audit Practice prepared by Audit Scotland and approved by the Auditor General for Scotland, sets out the ways in which auditors should carry out their functions under the Public Finance and Accountability (Scotland) Act 2000. With reference to the Code of Audit Practice, the main elements of our audit work in 2010/11 have been:

   - Audit of the financial statements, including a review of the Statement on the System of Internal Control
   - Review of governance arrangements, internal controls and financial systems

   The key issues from these outputs are summarised in this annual report.

6. This report is addressed to the Board and the Auditor General for Scotland and will be published on Audit Scotland's website, www.audit-scotland.gov.uk

Financial Statements

Introduction

7. The financial statements are a key way for Creative Scotland to demonstrate stewardship of the resources made available to them. In this section we set out our audit opinion and summarise the main issues found as a result of our audit work on the financial statements of Creative Scotland and Creative Scotland National Lottery Distribution Fund (NLDF).

Our responsibilities

8. We audit the financial statements and give an opinion on:

- whether they give a true and fair view in accordance with the Public Services Reform (Scotland) Act 2010 or the National Lottery etc Act 1993 and directions made thereunder by the Scottish Ministers of the state of the body's affairs as at 31 March 2011 and of its net operating cost/surplus for the year then ended
- whether they have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2010/11 FReM
- whether they have been prepared in accordance with the requirements of the Public Services Reform (Scotland) Act 2010 or the National Lottery etc Act 1993 and directions made thereunder by the Scottish Ministers
- whether, in all material respects, the expenditure and receipts in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers
- whether the part of the Remuneration Report to be audited has been properly prepared in accordance with the Public Services Reform (Scotland) Act 2010 or the National Lottery etc Act 1993 and directions made thereunder by the Scottish Ministers
- whether the information given in the Management Commentary included in the Annual Report for the financial year for which the financial statements are prepared is consistent with the financial statements

9. We are also required to report by exception if, in our opinion:

- adequate accounting records have not been kept
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records
- we have not received all the information and explanations we require for our audit
- the Statement on Internal Control does not comply with Scottish Government guidance

Independence

10. International Standard on Auditing 260 – Communication with those Charged with Governance – requires us to ensure that those charged with governance are appropriately informed on a timely

basis of all significant facts and matters that bear upon the auditor's objectivity and independence. In addition to the audit of the financial statements, Scott-Moncrieff provided Creative Scotland with support in the following areas during the year:

- Development of the corporate budget; the chart of accounts and management reports and the data transfer from the legacy organisations to Creative Scotland
- Restating the Scottish Arts Council financial statements to comply with international financial reporting standards

11. To ensure that these reviews complied with ethical standards and did not impact on the firm's objectivity and appearance of independence, the following safeguards were applied:

- The individuals providing support to Creative Scotland had no audit involvement with Creative Scotland or its predecessor bodies
- The support was provided under instruction of Creative Scotland staff and no management role was undertaken
- Senior members of the management team and audit committee were informed of these services

12. We can confirm that we have complied with the Auditing Practices Board Ethical Standard 1 – Integrity, Objectivity and Independence. In our professional judgement the audit process has been independent and our objectivity has not been compromised.

Overall conclusion

13. This annual report concludes the audit of Creative Scotland and Creative Scotland NLDF for the year ended 31 March 2011. We are pleased to report that our independent auditors' reports express an unqualified opinion on both sets of financial statements for the year ended 31 March 2011 and on the regularity of transactions reflected in those financial statements.

Accounts Direction

Creative Scotland

14. Creative Scotland is required, in preparing its financial statements, to comply with the directions given by Scottish Ministers. The Direction by Scottish Ministers requires Creative Scotland to comply with the accounting principles and disclosure requirements of the Government Financial Reporting Manual (FReM).

15. In respect of the financial year 2010/11, and to ensure transparency and recognise the requirements of section 42(b) of Part 4 of the Public Services Reform (Scotland) Act 2010, the Direction also required Creative Scotland to incorporate the following additional disclosure in its financial statements:

- A detailed note showing the assets and liabilities from Scottish Screen and the Scottish Arts Council, and any subsequent restatement of those by Creative Scotland to give the opening Creative Scotland balance sheet position as at 1 July 2010, and

- segmental reporting information to reflect the reporting period preceding and subsequent to the effective date with a reconciliation to the amounts reported in the accounts of the predecessor bodies

16. We are pleased to report that the 2010/11 financial statements of Creative Scotland comply with the 2010/11 edition of the FReM which was in force for the year when the statement of accounts were prepared. The financial statements also incorporate the additional disclosure as required by the Direction.

Creative Scotland National Lottery Distribution Fund

17. The Accounts Direction for Creative Scotland NLDF requires Creative Scotland to prepare a statement of accounts in respect of its National Lottery Distribution Activities which comply with the accounting principles and disclosure requirements of the Government Financial Reporting Manual (FReM).

18. In respect of the financial year 2010/11, and to ensure transparency and recognise the requirements of section 42(b) of Part 4 of the Public Services Reform (Scotland) Act 2010, the Direction also required Creative Scotland to incorporate a detailed note showing the assets and liabilities from Scottish Screen and the Scottish Arts Council National Lottery distribution activities, and any subsequent restatement of those by Creative Scotland to give the opening Creative Scotland National Lottery distribution activities balance sheet position as at 1 July 2010.

19. We are pleased to report that the 2010/11 financial statements of Creative Scotland NLDF comply with the 2010/11 edition of the FReM which was in force for the year when the statement of accounts were prepared. The financial statements also incorporate the additional disclosure as required by the Direction.

Creative Scotland and Creative Scotland NLDF 2010/11 financial statements

20. Discussions were held in 2010 between Creative Scotland management, the Scottish Government, Audit Scotland and external audit as to the accounting and auditing arrangements for the financial year 2010/11. It was agreed that merger accounting be adopted and therefore one set of statutory financial statements be prepared for the period 1 April 2010 – 31 March 2011 (one set for Creative Scotland and one for the national lottery distribution activities). Comparative figures were required for the financial year 2009/10.

21. During our audit we have reviewed the merger accounting used in the preparation of the financial statements and concluded that the accounts have been properly prepared in accordance with the FReM and International Financial Reporting Standards.

Scottish Arts Council

22. The Scottish Arts Council was a charitable NDPB and as a result three month statutory financial statements were required for the period 1 April 2010 to 30 June 2010, reflecting the

requirements of the charities statement of recommended practice (the SORP). We have audited these financial statements during the year. Our independent auditors' report expressed an unqualified opinion on the financial statements for the three month period ended 30 June 2010.

23. Furthermore, due to its charitable status, the Scottish Arts Council did not adopt international financial reporting standards (IFRS). Creative Scotland, on the other hand, does not have charitable status. The Accounts Direction for Creative Scotland requires that its financial statements are prepared in accordance with the FReM. The 2010/11 FReM applies EU adopted International Financial Reporting Standards (IFRS) and Interpretations in effect for accounting periods commencing on or before 1 January 2010.

24. During the year, the Scottish Arts Council financial statements were restated on an IFRS basis to enable the financial statements to be merged within Creative Scotland's financial statements. As part of our audit we reviewed the restatement of the Scottish Arts Council financial statements and concluded that the restated financial statements were appropriate for use as comparative amounts for the Creative Scotland IFRS based accounts.

Audit Adjustments

25. Adjustments were made over the course of the audit review to the Creative Scotland and Creative Scotland NLDF financial statements. All adjustments were agreed with the Director of Finance & Operations. The net effect on the financial statements is as follows (the detailed journals have been shown as an appendix to the letter of representation):

Table 1: Impact of Audit Adjustments on Financial Position

	Creative Scotland £'000	Creative Scotland NLDF £'000
Net deficit/increase on fund for the year – per draft financial statements	(53,630)	9,767
Net effect of adjustments made during the audit	(1,569)	0
Revised deficit per final accounts/increase on fund	(55,199)	9,767

26. We have also identified potential adjustments which are not considered material to the financial statements, either individually or in aggregate. These potential adjustments are shown as an appendix to the letter of representation and we ask the Board to confirm that they do not consider any unadjusted misstatement to be material.

Issues arising from the audit

27. We are required by international auditing standards to report to the Board the main issues arising from our audit of the financial statements. The most significant issues are noted below.

Leases

28. At 31 March 2011 Creative Scotland had committed to future lease payments under non-cancellable operating leases for the annual rent of three premises; Waterloo Place, Manor Place in Edinburgh and West George Street in Glasgow. The latter two relate to premises previously used by the Scottish Arts Council and Scottish Screen. The lease for 249 West George Street, is due to expire on 27 May 2014 with Creative Scotland having the flexibility of being able to exercise a break option on 31 March in any year on giving 12 months notice. The lease for Manor Place is due to expire on 8 June 2014. During the financial year Creative Scotland entered into a lease for a new Edinburgh office at Waterloo Place, the period of the lease is 15 years from the date of entry on 20 October 2010. This lease included the provision of a rent free period and a capital contribution towards fit out costs.

29. International Accounting Standard 17: *Leases* (IAS 17) prescribes the accounting arrangements for these transactions. IAS 17 requires that when a lease includes land and buildings elements, an entity assesses the classification of each element as either a finance or operating lease. Each lease must be considered as at its inception. Creative Scotland has deemed all three leases to be operating leases, though it has not formally considered the land and buildings element of each lease separately. During our review we considered each element and agreed with the accounting treatment adopted by Creative Scotland.

30. Standing Interpretations Committee interpretation 15: *Operating Leases – Incentives* (SIC 15) prescribes the treatment of any incentives which have been offered as part of a lease agreement. SIC 15 requires all incentives to be recognised as an integral part of the net consideration agreed for the use of the leased asset, irrespective of the incentive's nature or form or the timing of payments. The lessee should recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset. We have confirmed during our review that Creative Scotland has aggregated the value of the rent free period over the life of the lease. The value of the capital contribution however has not been aggregated across the life of the lease; the impact however is not considered material to the financial statements.

31. It is common for land and building leases to include clauses requiring the lessee to return the premise to its initial condition at the end of the lease term. The Scottish Arts Council and Scottish Screen recognised a provision for the cost of dilapidations to their relevant premises in 2009/10 and these have been reported in the 2010/11 Creative Scotland financial statements. Creative Scotland has not however recognised a provision for the cost of dilapidations at Waverley Gate, despite the lease requiring the lessee to return the premise to its initial condition at the end of the lease term.

Action Plan Point 1

Pensions

32. Creative Scotland participates in two defined benefit pension schemes; the Strathclyde Pension Fund (SPF) and the Arts Council Retirement Plan (ACRP). Creative Scotland is an admitted body of the Strathclyde Pension Fund, however, on 1 July 2010 the scheme was closed to new

members of Creative Scotland and all subsequent new starts are only admitted to the Arts Council Retirement Plan. International Accounting Standard 19: *Employee Benefits* (IAS 19) prescribes the accounting arrangements for post-employment benefits, such as pensions.

33. The SPF is accounted for as a defined benefit pension plan, in line with IAS 19. At 31 March 2010, Creative Scotland reported a net liability of £618,000. At 31 March 2011 this had decreased to a net pension asset of £224,000.

34. The Chancellor's decision to allow the valuation of public sector pensions to be based on the Consumer's Price Index (CPI) instead of the Retail Price Index (RPI) has had a significant impact on this year's valuation of the pension scheme. Creative Scotland has reported a past service gain due to the change from RPI to CPI of £459,000. This has significantly reduced the net pension asset/liability. The fair value of the employer assets has also improved during the year (by £430,000). This also contributes to the net pension asset position reported as at 31 March 2011.

35. Although the ACRP is a defined benefit scheme, it has been disclosed as a defined contribution plan. This is allowed under IAS 19 if a body is unable to identify its share of the underlying notional assets and liabilities of the scheme on a consistent and reasonable basis. We have been informed by the scheme actuary that this accounting treatment is reasonable due to the potential for cross subsidy between employers within the Plan. The complexity of allocating the current obligation and the lack of a consistent and reliable basis for allocating the assets makes disclosure as a defined benefit scheme impractical.

36. IAS 19 recognises that multi-employer plans may contain a contractual agreement which determines how the surplus or deficit in the plan will be distributed to, or funded by the participants. Where this is the case and the plan is accounted for on a defined contribution basis, as with the ACRP, the participant shall recognise the asset or liability that arises from the contractual agreement and the resulting income or expense in profit or loss. To meet this requirement Creative Scotland has recognised, following an audit adjustment, a liability of £1.627m in respect of the deficit arising on past service benefits.

Voluntary Severance Scheme

37. The Scottish Public Finance Manual (SPFM) includes guidance on severance, early retirement and redundancy terms. As part of the transition to Creative Scotland, a Voluntary Early Severance scheme (VES) was put in place. We have reviewed the regularity of the scheme and the required accounting entries.

38. A provision of £21,000 has been recognised at the balance sheet date in respect of VES. This relates directly to four individuals who have agreed a leaving date of 30 April 2011. The agreements have been formally reached between the Chief Executive and the individuals involved before the balance sheet date. The provision covers solely the early severance costs allowed by the relevant conditions of service for each individual. We have confirmed with

Creative Scotland that the relevant scheme actuaries have been informed of all pension scheme members leaving through VES during the year.

39. The VES scheme has comprised four phases over the transition and in total thirty individuals have agreed to take part. This has led to VES costs of £838,000 being incurred by Creative Scotland, including the £21,000 provision noted above. In line with the SPFM, Creative Scotland has obtained prior Scottish Government approval for this VES scheme.

Taxation

40. Creative Scotland has been created under the Public Services Reform (Scotland) Act 2010 as a body corporate. This Act has not exempt it from corporation tax and as such falls within the corporation tax provisions. Creative Scotland is therefore chargeable to corporation tax on any trading profit, income and gains. If Creative Scotland does not carry on a trade it will only be taxable on its other income such as bank interest and capital gains. Whether it is carrying on a trade is dependent on a detailed consideration of the facts.

41. Creative Scotland is currently working with its advisors and HMRC on whether its activities are tradable and therefore taxable. If this route is accepted by HMRC Creative Scotland would still be taxable on chargeable gains and bank interest.

42. A further review is ongoing over the transfer of assets from the Scottish Arts Council. The Scottish Arts Council as a charity cannot normally give away its assets without tax implications unless it gives them to another charity. Creative Scotland's advisors are in discussion with HMRC in relation to the tax treatment of the transfer of assets. Based on the most recent information, Creative Scotland believes the probability of a tax liability crystallising is low, but is subject to agreement with HMRC. This has been disclosed as a contingent liability in the financial statements. The potential liability has been estimated at £660,000.

Financial systems

43. Creative Scotland has decided to use the financial ledger system previously used by the Scottish Arts Council until a new accounting package is acquired. During the year, journals were created to transfer data from the Scottish Screen financial system to the Creative Scotland financial ledger system. Initially the two legacy organisation's transactions were operating through separate codes on the ledger. Work however has been carried out to develop a single set of financial codes for Creative Scotland, which was in operation by the end of the financial year. During our audit we confirmed that the balances from the Scottish Arts Council and Scottish Screen had been transferred correctly to the Creative Scotland financial ledger system.

Final payment of grants

44. Creative Scotland has a grant payment process in place whereby the first 90% of a grant is paid on approval of the application. The final 10% is paid on receipt of a final project monitoring report. Whilst we are aware that this process is already under scrutiny and payment plans are becoming more graduated, there are many cases where the final project monitoring report is not

received in a timely manner and as such the remaining 10% continues to be a liability on Creative Scotland's balance sheet.

45. We found that there are no specific timeframes or procedures relating to the follow up of project monitoring reports and would recommend that this is remedied to ensure that funds awarded are being spent on the intended project and in line with any original conditions of the grant if applicable.

46. We also recommend detailed procedures are implemented to review uncompleted projects regularly and ensure that where the final project monitoring report has not been received, Creative Scotland considers recalling the grant or writing off the amount outstanding.

Action Plan Point 2

Statement on Internal Control

47. As part of our audit we have considered the statement on the system of internal control, included within the Annual Report and Financial Statements for Creative Scotland and Creative Scotland NLDF. We are satisfied that the statements are consistent with guidance issued by Scottish Ministers and that the contents are not inconsistent with information gathered during the course of our normal audit work.

Regularity

48. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors to certify that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have issued an unqualified opinion on the regularity of transactions in Creative Scotland and Creative Scotland NLDF.

49. We have also concluded that the financial statements and the part of the Remuneration Report to be audited for both Creative Scotland and the Creative Scotland NLDF have been properly prepared in accordance with guidance issued by Scottish Ministers, and that information in the management commentary which is included within the Annual Report is consistent with the financial statements.

Use of resources

50. This section sets out our main findings from our review of how Creative Scotland manages its key resources in terms of its financial position.

Financial performance in 2010/11

51. Creative Scotland has reported a net operating deficit of £55.199m in year. This deficit is offset through grant-in-aid income received from the Scottish Government which is recognised through the general reserve rather than the Statement of Comprehensive Income. The table below provides a summary of Creative Scotland's financial results for the year:

Table 2: Creative Scotland Grant In Aid financial performance 2010/11

	2010/11 £'000	2009/10 £'000
Income	2,933	3,933
	2,933	**3,933**
Staff costs	(5,821)	(4,705)
Depreciation	(210)	(180)
Project expenditure	(554)	(1,639)
Grants, awards and investments	(48,344)	(49,903)
Direct delivery expenditure	(747)	(456)
Other operating expenditure	(2,488)	(2,192)
Other expenditure	32	(154)
Total expenditure	**(58,132)**	**(59,229)**
Retained deficit for the year	**(55,199)**	**(55,296)**
Grant-in-aid	51,577	54,830
Capital grant income	415	0
Actuarial gain/(loss) on pension fund	361	(878)
Disposal of goodwill	0	986
Indexation of fixed assets	76	0
Net loss on revaluation	0	(424)
Total recognised gains and losses	**(2,770)**	**(782)**

Source: *Creative Scotland's Annual Report and Financial Statements 2010/11*

52. As highlighted in table 2, there was a reduction to the overall reserves of £2.770m in the year. While the total expenditure incurred in the year was £1.097m less in comparison to the previous year, the level of grant in aid and other income was also less than in the previous year (£3.838m), contributing to the reduction to the overall reserves as at 31 March 2011. Total

expenditure in the year includes the provision for additional contributions to the Arts Council Retirement Plan (£1.627m) referred to in paragraph 36.

53. Creative Scotland NLDF incurred expenditure of £14.153m in 2010/11 (2009/10: £24.253m) and received income of £23.920m (2009/10: £22.818m) including National Lottery Fund proceeds of £22.892m. The net impact was an increase in the fund of £9.767m during the year. In comparison with previous years, the level of grant award commitments decreased by £7.025m. The surplus does not reflect the 'soft' and 'other' commitments of £5.228m and was budgeted as the first allocation, to support the new £20m capital programme to be run over 4 years from 2011/12.

Budgetary Control

54. Creative Scotland inherited the 2010/11 budgets for both Scottish Arts Council and Scottish Screen. The combined budget for these organisations was approximately £53 million for grant in aid and £18 million for the national lottery distribution funds. The original budget forecast an overall surplus of £65,000 for grant in aid and £186,000 on the national lottery distribution funds.

55. At is first board meeting, the board agreed to free up between £5 million and £6 million for new initiatives. Work was carried out to refine and reallocate budgets to achieve this. The projected surplus for each account remained the same. The actual results are shown in the table below:

Table 3: Grant In Aid and Lottery Fund management accounts 31 March 2011

	Grant in Aid				Lottery Fund		
	Actual £'000	**Budget £'000**	**Variance £'000**		**Actual £'000**	**Budget £'000**	**Variance £'000**
Income	**53,054**	**53,448**	**(394)**		**24,920**	**18,780**	**6,140**
Investments, awards & projects	(48,773)	(45,818)	(2,955)		(13,314)	(16,079)	2,765
Direct activities	(749)	(1,029)	280		(48)	(307)	259
Operating costs	(7,155)	(6,536)	(619)		(1,791)	(2,208)	417
Total expenditure	**(56,677)**	**(53,383)**	**(3,294)**		**(15,153)**	**(18,594)**	**3,441**
Surplus/(Deficit)	**(3,623)**	**65**	**(3,688)**		**9,767**	**186**	**9,581**

Source: *Creative Scotland GIA and Lottery Fund management accounts period 12 March 2011*

56. As noted in the table above, there are significant variances reported for Creative Scotland grant in aid and the lottery fund when comparing the actual results to the budget for the year. The main reason for the variance on the grant in aid is due to the change in accounting treatment for 'soft' commitments and 'other' awards at Creative Scotland (in comparison to the treatment adopted by the Scottish Arts Council as a charitable organisation). All awards have been recognised in the year resulting in an adverse variance against budget as the budget had not been updated to reflect this change in accounting treatment, the intention by management being to utilise reserves. In relation to the variance in operating costs, this is due to the provision for

additional contributions to the Arts Council Retirement Plan (£1.627m). With regard to the lottery fund, a number of projects were not progressed due to it being a transition year.

57. During 2010/11 management accounts were prepared for the periods up to November 2010, December 2010 and March 2011. No management accounts have been produced so far for 2011/12. We understand however Creative Scotland intends to prepare management accounts on a monthly basis.

Action Plan Point 3

58. The core funding for Creative Scotland was protected in its 2011/12 budget as significant efficiencies have been made through the move to a single arts and culture body. The core funding agreement is however only in place for one year. Further reductions are expected across the country and Creative Scotland has anticipated for a 3% efficiency saving target in its operating costs budget over the next 3 years, by taking a single circa 10% reduction in operating costs in the 2011/12 budget. In anticipation of further reductions, Creative Scotland has carried out scenario planning to identify further ways of reducing costs and making savings. The Scottish Government is expected to deliver its spending review in 2011 and announce the funding settlement for 2012/13 in September.

Workforce management

59. The creation of Creative Scotland from two legacy organisations has led to significant changes in the workforce. As noted in paragraph 37, a voluntary severance scheme was launched during the transition to Creative Scotland. To date thirty members of staff had taken voluntary early severance. A process of job matching was carried out in order to fill the new Creative Scotland posts from staff who previously worked for either Scottish Screen or the Scottish Arts Council. Where there were two people who could fill the position interviews were carried out. The members of staff that were unsuccessful in interviews were offered alternative positions within the organisation. Once the process of job matching was completed, positions which had not been filled were advertised externally.

60. Following the matching process most members of staff remained on their former salary, unless they were taking on extra responsibility, such as line management responsibility. No staff experienced a reduction in their salary as after taking on a new role.

61. The process of harmonising terms and conditions and agreeing a new pay structure is in progress. In the interim, former employees of both Scottish Screen and the Scottish Arts Council remain on their existing pay scales and terms and conditions, in line with the TUPE transfer. New members of staff joining the organisation since Creative Scotland was formed go onto a Creative Scotland contract.

Cost of transition to Creative Scotland

62. The estimated costs from setting up Creative Scotland were set out in the Financial Memorandum and a Scottish Government SPICe (Scottish Parliament Information Centre) briefing ‘Public Services Reform (Scotland) Bill Finance Committee Scrutiny’ (August 2009). The

total cost of transition ranged from £2.064 million to £4.444 million (with the best estimate set at £3.315 million). This includes costs associated with the Creative Scotland transition project and team for 2007/08 and 2008/09 and Creative Scotland 2009 Ltd. Excluding these amounts the best estimate for the transition to Creative Scotland was £2.348 million. Previously the cost of transition work was shared between the Scottish Arts Council and Scottish Screen. The Scottish Government however agreed to meet the costs of transition so that the resources available to support the sector would not be affected. Business cases have been submitted to the Scottish Government in relation to these costs. The table below shows the costs incurred by Creative Scotland in 2010/11. It has not been possible to obtain an accurate position of the costs incurred by the Scottish Arts Council and Scottish Screen in previous years.

Table 4: transition costs

		Best Estimate £'000	2010/11 £'000
Staff Costs	Development of pay and grading structure	30	27
	Harmonisation of terms and conditions	200	12
	Staff pensions	265	27
	Voluntary early severance	1,100	838
	Training and recruitment	235	93
	Sub-total	**1,830**	**997**
Non Staff Costs	Business Systems	400	263
	Leases and re-branding	75	6
	Legal Fees	8	149
	Board appointments	35	0
	Sub-total	**518**	**418**
	Total	**2,348**	**1,415**

Source: SPICe briefing and Creative Scotland papers

Performance

Introduction

63. To ensure effective performance, Creative Scotland needs both a clear strategy that defines what it aims to achieve and appropriate processes in place to effectively monitor and measure its outputs.

Creative Scotland's Corporate Plan: Investing in Scotland's Creative Future

64. In recognition that Creative Scotland would be established in 2010/11, the Scottish Arts Council and Scottish Screen prepared a joint corporate plan for 2010/11. The joint corporate plan covered both joint working and individual plans for both the Scottish Arts Council and Scottish Screen. In developing the plan, both the Scottish Arts Council and Scottish Screen committed to delivering against the four national priorities the Scottish Government had indicated for Creative Scotland (table 5) and developed a set of ten high level programmes for 2010/11 against which both organisations could report their achievements.

Table 5: Creative Scotland national priorities
1. Encourage and sustain artists and creators of all kinds
2. Ensure that their work is accessible to all
3. Ensure that as many people as possible can participate in creative activities
4. Extend and increase the wider benefits of arts and culture, including their contribution to the promotion and development of our unique national culture and its wider place in the international sphere
Source: Scottish Arts Council & Scottish Screen Joint Corporate Plan

65. From July 2010, Creative Scotland was responsible for taking forward a legacy of work from both the Scottish Arts Council and Scottish Screen. It also inherited work delivered under the auspices of CS09 Ltd. In 2010/11, Creative Scotland's focus has been to ensure no detrimental impact on supported sectors by committing to continue to manage inherited programmes.

66. At the same time, significant work has been undertaken to develop the strategic direction of Creative Scotland; as a newly formed organisation. Creative Scotland published its corporate plan in March 2011. The plan covers the period 2011 – 2014 and outlines its mission and objectives (table 6). It includes the organisation's aspirations for the next ten years as well as a detailed three year plan.

Table 6: Creative Scotland's mission, vision and objectives
Mission: To invest in Scotland's Creative Future
Vision: That Scotland is recognised as a leading creative nation – one that attracts, develops and retains talent, where the arts and the creative industries are supported and celebrated and their economic contribution fully captured; a nation where the arts and creativity play a central part in the lives, education and well-being of our population.
Objectives: • To invest in talent • To invest in quality artistic production • To invest in audiences, access and participation • To invest in the cultural economy • To invest in places and their contribution to a creative Scotland
Three cross cutting themes underpin its objectives: • Education and a commitment to a generational change in cultural opportunity • International partnership to reflect Scotland's global outlook • Equalities in all areas of our work
Source: Investing in Scotland's Creative Future Corporate Plan 2011-2014 (Creative Scotland's Corporate Plan)

67. The corporate plan was presented to over 700 individuals through a series of road shows covering Inverness, Aberdeen, Glasgow, Dunkeld, New Galloway and Edinburgh. The road show included a presentation and question and answer session. The notes from these road shows are now available on Creative Scotland's website. Overall Creative Scotland believes its Corporate Plan has been well received.

Performance Management

68. Creative Scotland has yet to develop a performance management framework. To date, the Board has received regular updates from the Chief Executive on activity across the organisation. There is a risk that the board is given insufficient information to scrutinise the performance of the organisation.

69. Creative Scotland intends to develop a performance management framework which will include performance measures and indicators that will enable:

- High level baseline research to track trends
- Systematic monitoring of investments and the performance of cultural organisations
- Evaluation of major programmes and projects
- Reporting against the Scottish Government's outcomes

Action Plan Point 4

70. In reporting on the Scottish Government's outcomes Creative Scotland intends to report against seven of the national objectives set out in the National Performance Framework.

Best Value

71. Best Value is defined as the continuous improvement in the performance of functions. The positive impact of the Best Value concept in local government led Scottish Ministers to introduce a non-statutory Best Value duty on all public sector accountable officers (i.e. across central government) in 2002. This was reinforced by refreshed Ministerial guidance highlighting the importance that the Scottish Government places on Best Value as a means of supporting public service reform. The *Scottish Public Finance Manual* now places a duty on the Chief Executive, as Accountable Officer, to make arrangements to secure Best Value. Additionally, the Scottish Government's response to the Crerar scrutiny review credited the Best Value regime as a key driver of modernisation and improvement in public services.

72. Audit Scotland is continuing to develop its approach to the audit of best value in central government bodies. Audit Scotland has developed a range of best value toolkits which can be applied to organisations. These are available on Audit Scotland's website, www.audit-scotland.gov.uk. Creative Scotland is currently working on developing and embedding its overall governance and performance arrangements and as such we have not carried out a best value audit in 2010/11.

National Studies

73. Audit Scotland has prepared National Studies in a variety of areas. There is an expectation that central government bodies review the National Studies relevant to them and action them accordingly. As external auditors, Audit Scotland, requires Scott-Moncrieff to complete a pro forma template for each National Study which will address the following points:

- Was the national report discussed at any of the body's committees and on what dates?
- Did the body carry out a self assessment against the national report?
- Did the board produce an action plan? A copy of which is to be submitted to Audit Scotland.
- Are there plans to provide the committee(s) with feedback on the actions?

74. During our 2010/11 audit we reviewed the action Creative Scotland has taken in relation to the following reports:

- The role of boards
- Improving energy efficiency: a follow up report

75. Due to the significant changes required during the transition to Creative Scotland, the Board and management team have focussed their attention on establishing the organisation and have not been available to review the national reports. The management team has acknowledged the importance of these reports and we understand arrangements will be put in place to consider these reports in the future.

Action Plan Point 5

Governance

76. This section sets out the main findings arising from our review of Creative Scotland's governance arrangements. Our review has been tailored to reflect progress made by Creative Scotland in developing its governance arrangements. Management within Creative Scotland continue to develop and embed overall governance arrangements for the organisation. This includes, for example, Creative Scotland's corporate plan and risk management arrangements. Overall we have concluded that satisfactory progress has been made to date.

Board of Creative Scotland

77. Creative Scotland's Board of Directors has corporate responsibility for ensuring that Creative Scotland fulfils its aims and objectives. The Creative Scotland Board of Directors was appointed on 1 July 2010 and currently comprises nine non-executive directors (the Public Services Reform (Scotland) Act allows for up to a maximum of fourteen members). Board directors are appointed by Scottish Ministers for a period of either two or four years. Only one director from the previous Scottish Arts Council and Scottish Screen Joint Board has been appointed to the Creative Scotland Board. In addition, one director from the CS09 Ltd Board has been appointed to the Creative Scotland Board. The Chair of the Board is entitled to remuneration at a rate set by the Scottish Government. In 2010/11, however, the Chair received no remuneration having declined the offer of a remuneration package.

78. Formal induction arrangements were established for the board. At the first board meeting, the management team delivered a training session to the board, covering areas such as:

- the relationship between Creative Scotland, national performing companies and youth performing companies
- legislation impacting on Creative Scotland (including the Public Services Reform (Scotland) Act 2010
- financial information
- key governance documents, including the management statement and financial memorandum for Creative Scotland
- codes of conduct

79. Board members were required to confirm that they had read and understood their roles and responsibilities at this meeting. The Board has since been given the opportunity to attend CIPFA's 'on board' training session. Two directors have attended this session.

80. The management team has recently produced a draft skills matrix for the Board which the Chair will consider for use to assess the overall skill mix of board members. This assessment will provide assurance to the Chair that the Board has the right skills, knowledge and expertise. The skills matrix will also be used to inform the appointment of additional directors to the Board.

81. It is also expected that the Board will carry out an annual review of its performance. Due to the timing of our audit, this review had yet to be carried out. We would expect this review however to identify any training and development needs for the Board.

82. The Board has met five times since its creation in July 2010 and attendance by board members has been good (on average 88% attendance). During this time, the Board has been involved in developing and approving the main strategic documents (the 2011-2014 Corporate Plan and 2011/12 Operational Plan), governance arrangements (committee structure, scheme of delegation), as well scrutinising financial performance and risk. Board meetings are not open to the public however board minutes can be accessed on Creative Scotland's website.

83. The Ethical Standards in Public Life etc. (Scotland) Act 2000 requires all public bodies to keep a public list, or register, of individual board members' interests which records their other interests and activities that could influence their work as a board member. We confirmed during our audit that a register of interests is in place. Arrangements are also in place for board members to declare a conflict of interest at the start of a Board meeting. Board members are required to leave the meeting when they are unable to participate objectively in any discussion.

84. The Board has delegated certain matters to sub-committees, including an audit and risk committee and remuneration committee. The terms of reference state that the Chair of the board also chairs the remuneration committee and the other members are elected by the board. All the members of the audit and risk committee are elected by the board. The audit committee is required to meet at least three times per year and the remuneration committee will meet at least once a year. We confirmed during our audit, that the frequency of meetings to date was in line with the approved terms of reference.

85. Over the coming year, the Board is expected to be involved in specific projects. As an organisation, Creative Scotland intends to carry out sector reviews of the main creative sectors. This work will be carried out by small project teams with one board member represented on each project team.

Risk Management

86. An important feature of a robust system of internal control is a developed and integrated approach to risk management. Effective risk management will deliver an appropriate balance between risk and control, more effective decision making, better use of limited resources and greater innovation. Creative Scotland has recently developed its risk management arrangements. Our review of the arrangements has therefore been limited. Over the coming year, it is essential that Creative Scotland ensure and can demonstrate that these arrangements are fully embedded across the organisation.

87. A business risk assessment register has been developed which identifies the organisation's key risks. Risk management is a standing item on the weekly senior management team meetings and the business risk assessment register was first presented to the audit and risk committee in May 2011. At this meeting, the committee reviewed the format and content of the register and

concluded that the risk management controls in place are good. Risk management will be a standing item on the audit and risk committee agenda.

88. Whilst responsibility for risk management has been delegated to the audit and risk committee, it is important that the whole board regularly considers risk and any preventative action that can be taken.

Action Plan Point 6

Standards of conduct, integrity and openness

89. Propriety requires that public business is conducted with fairness and integrity. Guidance on standards of conduct, accountability and openness has been issued by the Scottish Government. Our work in this area included a review of the arrangements against our standards of conduct checklist and review of the register of interests. We are pleased to report that our audit identified no issues of concern in relation to standards of conduct, integrity and openness.

Internal Audit

90. Internal Audit is a key component of Creative Scotland's internal control framework. Deloitte provide an internal audit service to Creative Scotland.

91. In accordance with the Code of Audit Practice and International Standard on Auditing 610 – Considering the work of internal audit, "the external auditor should perform an assessment of the internal audit function when internal auditing is relevant to the external auditor's risk assessment". Overall we concluded that reliance could be placed on the work of internal audit.

92. To avoid duplication of effort and to ensure an efficient audit process, we have made use of internal audit work where appropriate.

Fraud and Irregularity

93. Our audit has been planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity. As part of our governance work we reviewed the arrangements in place to prevent and detect fraud and irregularity.

94. During our audit we were notified of a potential external fraud at Creative Scotland. This is currently being reviewed by Creative Scotland's internal auditors. At the time, Creative Scotland was in the processing of developing a fraud response plan and has drawn upon guidance from the Scottish Government. It is essential that the fraud response plan is completed and approved as soon as possible.

Action Plan Point 7

Legality

95. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially effect the financial statements. Our audit procedures included the following:

- Reviewing minutes of relevant meetings;
- Enquiring of senior management and the organisation's solicitors concerning litigation, claims and assessments; and
- Performing detailed testing of transactions and balances.

96. We are pleased to report that we did not identify any instances of concern with regard to the legality of transactions or events.

Appendix 1: Action Plan

Our action plan details the key weaknesses and opportunities for improvement that we have identified during this review. To assist Creative Scotland in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. The rating structure is summarised as follows:

5	Very high risk exposure - Major concerns requiring immediate Board attention.
4	High risk exposure - Absence / failure of significant key controls.
3	Moderate risk exposure - Not all key control procedures are working effectively.
2	Limited risk exposure - Minor control procedures are not in place / not working effectively.
1	Efficiency / housekeeping point.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

No	Title	Risk and Recommendation	Management comments
1	**Leases**	Creative Scotland has not recognised a provision for the cost of dilapidations at Waverley Gate, despite the lease requiring the lessee to return the premise to its initial condition at the end of the lease term. There is a risk that Creative Scotland understates its liabilities by not recognising a provision for restoring Waverley Gate back to its original state at the end of the lease. We recommend that Creative Scotland consider the need for a provision in future accounts. **Priority 2**	The lease is for 15 years and CS only took position in Oct 2010. CS will, as good practice, consider a provision for dilapidations in future accounts.
2	**Final payment of grants**	During our audit we found, for a number of grants awarded, that the final management report is still outstanding. As a result the final payment has not been made. There is a risk that Creative Scotland has distributed funds which are not being used for their intended purpose. We also found that there are no specific timeframes or procedures relating to the follow up of project monitoring reports. We would recommend that this is remedied to ensure that funds awarded are being spent on the intended project and in line with any original conditions of the grant if applicable. We also recommend detailed procedures are implemented to review uncompleted projects regularly and ensure that where the final project monitoring report has not been received, Creative	With regard to the 90/10 split – CS agrees that this not appropriate and has phased this out. Default is for quarterly payments and for smaller level awards a 75/25% split. The purpose is to ensure payments were being raised against approved delivery/progress of project. Business Affairs is still receiving requests for 90/10% split and where this has been requested, has sought a rationale as to why this should be the case and this is put on file, as is going against our own control process – i.e. exception basis. CS Management agrees that work is required in the area of project review and monitoring and also with regard to review of uncompleted projects with a view to withdrawing investment. This is an area for progression during the year

No	Title	Risk and Recommendation	Management comments
		Scotland considers recalling the grant or writing off the amount outstanding. **Priority 3**	
3	**Management Accounts**	Creative Scotland intends to report actual financial position against budget in the form of management accounts on a monthly basis. During 2010/11 however only three sets of management accounts were produced, in November, December and March. No management accounts have been produced to date for 2011/12. There is a risk that there is not sufficient control over the Creative Scotland budget during the year. This could lead to over-commitment of funds. We recommend that Creative Scotland ensure that management accounts are produce and reported to management and the board on a regular basis to ensure effective monitoring of the financial position can take place. **Priority 4**	CS Management agree with this point and are establishing a schedule of monthly management reports tailored to audiences – ie budget holder / SMT / Board, to support effective organisational management. Subsequent to the audit, this area has been progressed and management accounts for Lottery and GIA have been developed for the 1st quarter and the detailed reports will be reviewed by the Senior Management team at their meeting of the 6 September and abbreviated reports issued to the Board for their meeting of the 16 September. Management accounts and reports will be completed moving forward on a monthly basis. In addition monthly budget holder meetings are being scheduled between Finance and budget holders to discuss in detail budget variances; balance sheet items and projections. Budget holder training sessions are also being developed to support the guidance already issued.
4	**Performance Management**	Creative Scotland has yet to develop a performance management framework. To date, the Board has received an update from the Chief Executive on activity across the organisation. There is a risk that the board is given insufficient information to scrutinise the performance of the organisation.	CS Management is aware that this is an area that requires progression, as we are only at the early stages of development. To date we have: • In our corporate plan, identified the outcomes CS will report

No	Title	Risk and Recommendation	Management comments
		Priority 4	against from the National Performance Framework. • In our new managed funds investment programme launched this financial year (11/12) we will identify how investments meet our corporate objectives of talent, quality production etc. • Further work is underway by one of the Creative Directors to consider what information portfolio managers and development officers need to gather and review, so they can determine whether their projects are progressing and have succeeded. • Consideration of performance management and monitoring requirements are being considered as a critical function within our specification design for the new Investment Admin system. Flexibility of 'fields' will be sought, thereby future proofing the system to be able it accommodate changing targets and measures. We need to consolidate the work to date and further develop into a performance framework for the organisation, to enable reporting to support effective decision making; reporting to the Board and Scottish Government on performance; publicity – proactive communication as well as for other general reporting requirements. The Senior Management Team will consider how this area of work is progressed and what external resource could be utilised to support this.

No	Title	Risk and Recommendation	Management comments
5	**Audit Scotland National Studies**	Due to the significant changes required during the transition to Creative Scotland, the Board and management team have focussed their attention on establishing the organisation and have not been available to review the Audit Scotland national reports. The management team has acknowledged the importance of these reports and we would encourage the management team and board to review, where appropriate, Creative Scotland's position against key recommendations in the report. **Priority 2**	CS management acknowledge the importance of these reports and therefore the recommendation and will action accordingly.
6	**Risk Management**	Whilst responsibility for risk management has been delegated to the audit and risk committee, it is important that the whole board regularly considers risk and any preventative action that can be taken. There is a risk that the whole board is not aware of the key risks affecting the organisation and how these are being controlled. **Priority 3**	The Audit and Risk Committee currently report to the Board through the minutes of Committee meetings and also at the Board meetings. To further enhance the current reporting the Committee propose to present the Business Risk Assessment Register to the Board on an annual basis, with the first occasion being at the meeting of the 9 December.
7	**Fraud and Irregularity**	During our audit we were notified of a potential external fraud at Creative Scotland. This is currently being reviewed by Creative Scotland's internal auditors. At the time, Creative Scotland was in the process of developing a fraud response plan and has drawn upon guidance from the Scottish Government. It is essential that the fraud response plan is completed and approved as soon as possible. **Priority 4**	CS Management agree with this recommendation and work is underway in the development of the fraud policy and response plan. The completed policy and response plan will be reviewed by Deloittes as part of their external review of the fraud investigation, management and proposed process and control improvements. The Fraud Policy and Response plan and Deloitte's report will be presented to the Audit and Risk Committee at their meeting of the 23 November 2011.

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