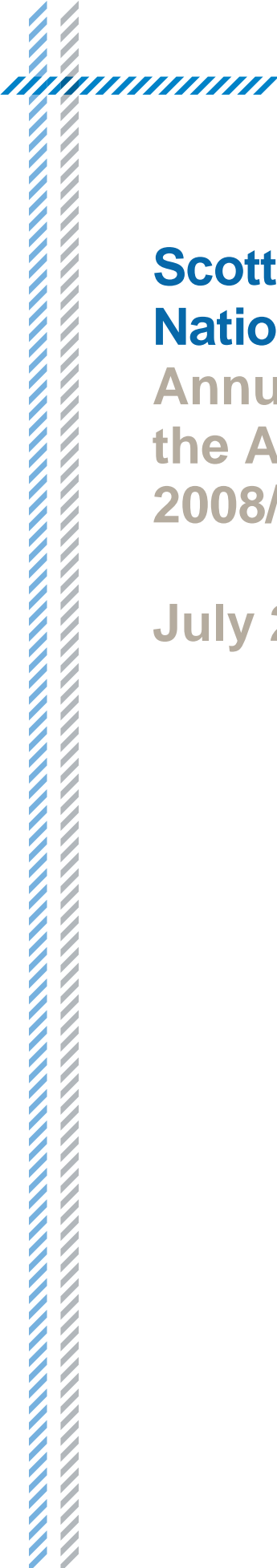




SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW




Scottish Screen
National Lottery Distribution Fund
Annual Report to the Joint Board and
the Auditor General for Scotland
2008/09

July 2009



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Executive Summary

Governance

The Public Services Reform (Scotland) Bill was introduced in May 2009. The Government proposes that *“Creative Scotland will be substantially different from the two existing bodies (and) achieve a coordinated approach to supporting and developing”* arts and culture. This suggests there will be a significant governance impact and changes will be required to strategic and operational planning.

Scottish Screen and the Scottish Arts Council have been operating under a Joint Board and related Committee structure since 1 February 2007 and will continue to do so until the establishment of Creative Scotland in Spring 2010. From January 2009, the Scottish Screen and Scottish Arts Council Boards have held individual meetings and joint meetings to allow management to focus on both individual organisational responsibilities as well as joint working arrangements.

Performance

During 2008/09 a review of the lottery investment and award process was undertaken, resulting in changes to the investment strands in place. Management will continue to monitor regularly the success of investment strands and respond to the evolving requirements of the sector.

Scottish Screen National Lottery Distribution Fund (SSNLDF) continued the development of the new CRM (Client Relationship Management) system. This system allows for more robust monitoring of project performance and informs future decision making.

Finance

Our audit opinion on the truth and fairness of the annual accounts and on the regularity of transactions is unqualified. The deadline for submitting final accounts will be achieved.

SSNLDF incurred expenditure of £2.705m in 2008/09 and received income of £2.664m including £2.427m from the National Lottery Distribution Fund. This has resulted in a decrease in the fund of £41,000. SSNLDF reported a balance of £4.097m held with the National Lottery Distribution Fund as at 31 March 2009, and a net asset position of £2.994m.

Conclusion

This report concludes the 2008/09 audit of SSNLDF, which has been performed in accordance with the Code of Audit Practice issued by Audit Scotland.

This report has been discussed and agreed with the Chief Executive and Chief Operating Officer. We would like to thank all management and staff for their co-operation and assistance during our audit.

Scott-Moncrieff, July 2009

Introduction

Auditor General and Audit Scotland

1. The Auditor General for Scotland is responsible for reporting to the Scottish Parliament on how public bodies spend public money, manage their finances and achieve value for money in the use of public funds. In discharging this responsibility the Auditor General appoints central government auditors and sets the terms of their appointment. The Auditor General has appointed Scott-Moncrieff as auditors of Scottish Screen National Lottery Distribution Fund (SSNLDF) for the five year period 2006/07 to 2010/11. We are not the appointed auditors of Scottish Screen Ltd or its subsidiary, Scottish Screen Enterprise Limited.
2. Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out his statutory functions, including preparing a Code of Audit Practice setting out the role and responsibilities of the external auditor.
3. The purpose of this report is to summarise the results of our audit work for 2008/09. The report describes the ways in which the requirements of the Code of Audit Practice have been met by SSNLDF and by us.

Independence and ethical standards

4. Ethical Standard 1 – Integrity, objectivity and independence, issued by the Auditing Practices Board (APB), requires that external auditors ensure that the Audit Committee is appropriately informed on a timely basis of all significant facts and matters that bear upon the auditors' objectivity and independence.
5. We confirm that we have complied with APB Ethical Standards throughout our audit and that, in our professional judgement, we have remained independent and our objectivity has not been compromised in any way. In particular:
 - There are and have been no relationships between Scott-Moncrieff and SSNLDF, its directors and senior management that may reasonably be thought to bear on our objectivity and independence; and
 - Scott-Moncrieff has not provided any consultancy or non-audit services to SSNLDF.

Scope of the Audit

6. The audit work we undertake relates to three main areas: governance, performance and finance. The main audit objective for each of these areas is summarised below, along with the key priorities and risks for each area.

Audit areas and audit objectives

Audit area	Audit objective
Governance	To review SSNLDF's governance arrangements in relation to: <ul style="list-style-type: none">• systems of internal control and risk management,• the prevention and detection of fraud and irregularity,• standards of conduct and prevention and detection of corruption.
Performance	To review SSNLDF's arrangements for managing its performance and for securing economy, efficiency and effectiveness in its use of resources.
Finance	To provide an opinion on the truth and fairness of SSNLDF's financial statements and on the regularity of transactions. To review SSNLDF's financial standing and financial management arrangements.

7. The remainder of this report sets out the results of our work in 2008/09 under the headings of Governance, Performance and Finance. The action plan at the end of the report details the recommendations we have made during the year.

Governance

Creative Scotland

8. Following a review of the arts and creative sector in Scotland by the Cultural Commission, the Scottish Executive announced that Scottish Screen and Scottish Arts Council will be replaced by a new body called Creative Scotland. This will have a significant impact on the structure and governance of the creative sector in Scotland. Legislation which will give statutory powers to the new organisation was presented to the Scottish Government in May 2009 through the Public Services Reform (Scotland) Bill.
9. A Joint Board for Scottish Screen and Scottish Arts Council is in operation and will continue until the new body is created. During 2008/09 Creative Scotland Ltd was established to facilitate the transition process. A 12 month transitional plan has been developed with the new Board expected to be in place by Spring 2010. The Scottish Government is currently considering issues relating to organisational structure, status and timescales for enactment of the Parliamentary Bill, should it receive parliamentary approval.
10. Amongst these organisational changes, the future of the SSNLDF has still to be clarified. Scottish Screen was appointed by the National Lottery Act 1993 (as amended) and any changes to Scottish Screen will not automatically lead to changes in the structure and status of the Lottery Fund. Scottish Screen continues to discuss with the Scottish Government the arrangements and highlight issues to be considered for the transfer of responsibility for the Fund from Scottish Screen to Creative Scotland. This matter is being managed by the Scottish Government.

Statement on Internal Control

11. The framework of internal controls operating within SSNLDF is reported within the Statement on Internal Control (SIC) included with the annual accounts. No significant areas have been identified which require to be raised within the SIC. We are satisfied that the contents of the SIC are not inconsistent with information gathered during our normal audit work and that the statement is in line with Scottish Ministers' guidance.

Risk Management

12. Risk Management is important to the establishment and regular review of the system of internal control. Within Scottish Screen, the risk register is used as a key management tool and is a standing item for discussion at management team meetings. The register includes those risks which could potentially prevent the achievement of strategic aims and objectives. Risks also include organisational change issues in respect of Creative Scotland.
13. Scottish Screen has an established risk management process which is reasonable and appropriate for an entity of its size and nature.

Internal Audit

14. Internal audit is a key component of Scottish Screen's corporate governance arrangements. SSNLDF's internal audit service is provided by Wylie and Bisset. We considered the work undertaken by Wylie and Bisset to ensure it was sufficient in quality and volume and performed in accordance with accepted internal audit standards.
15. We have concluded that the internal audit service complies with relevant internal audit standards. In order to maximise the value of the total audit resources available to Scottish Screen, we have made use of internal audit where applicable to our external audit work and are grateful to Wylie and Bisset for their assistance in this respect.

Fraud, Irregularity and Corruption

16. We are required to consider the arrangements made by management for the prevention and detection of fraud, irregularity and corruption. Our audit identified no issues in this area.

Standards of Conduct, Integrity and Openness

17. 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.

Chief Executive's Pay Award

18. In 2008/09, Scottish Screen developed a new process for reviewing the Chief Executive's performance. This action responds to previous Scottish Government and external audit comment over the pay award process and looked to make potential bonus payments more aligned to "SMART" methodology and directly align it with Government guidance. Scottish Screen reviewed another NDPB's process, to share existing good practice and develop an appropriate performance assessment framework.
19. The revised process was adopted for the 2007/08 performance review and a retrospective analysis using this new system has been undertaken for 2006/07. Both of these assessments have been submitted to the Scottish Government for approval. The bonus award can be up to 5% of the Chief Executive's salary.
20. At time of our audit, the Chief Executive's bonus had not been formally approved by the Scottish Government. The bonus has been accrued into the financial statements until formal approval is received to make the payment. We recommend that Scottish Screen pursue the Scottish Government for clarification over this award.

Action Plan (Follow Up) Point 1

Performance

Organisational Review

21. During 2008/09 a review of the lottery investment and award process was undertaken, resulting in some minor changes to its investment strands. Management will continue to monitor regularly the success of investment strands and respond to the evolving requirements of the creative sector.
22. As a result of the review, a new market development fund was launched in July 2008, expanding on the previous distribution fund which had closed in March 2008. The future fund was incorporated into the content development fund and the festivals fund was incorporated with the audience development fund. In October 2008, following the half yearly review, the pilot fund was also incorporated in the content development fund.
23. During 2008/09 the investment strands were;
 - Content development
 - Content production
 - Short film production
 - Markets and festivals
 - Pilot fund
 - Slate fund
 - Express film fund
 - Audience development
 - Market development fund
 - New talent development fund

Revised Investment Guidelines

24. Investment guidelines were also reviewed and revised, in tandem with the changes to the investment strands. The aim is to support wider investment in each strand, allowing officers a greater degree of flexibility to support the best projects within the restrictions of reduced lottery income. The revision also looked to make the guidelines as clear and accessible as possible to all potential applicants.

25. During 2008/09, senior management also continued the development of the new CRM (Client Relationship Management) system. This system allows for more robust monitoring of project performance against investment agreements and informs future decision making.

Partnership Approach

26. Scottish Screen has a stated intention to work in partnership with other stakeholders within the industry. In 2006/07 and 2007/08, funds were delegated to Skillset Scotland, a specialist creative media training and support organisation.
27. 2008/09 represented the third and final year of the delegation agreement and SSNLDF is reviewing the success of this arrangement to identify the best way forward.

Best Value

28. We have found no evidence in the course of our audit work to indicate that the entity has operated in a manner which is inconsistent with the principles of best value.

Finance

Annual Accounts and Audit Timetable

29. We are pleased to report that we received draft annual accounts and working papers of a high standard in line with the agreed timetable.
30. The annual accounts are due to be approved by the Board on 28 August 2009 and submitted to the Scottish Government and the Auditor General for Scotland thereafter. The submission deadline of 31 October 2009 will be met.
31. Scottish Ministers have issued guidance to Scottish Screen, through an Accounts Direction, which requires it to prepare separate annual accounts for its Lottery Fund. This Accounts Direction is attached as an appendix to the annual accounts. Scottish Screen is required to comply with the Financial Reporting Manual (FRoM) when preparing these financial statements. The SSNLDF 2008/09 accounts comply with the requirements of the FRoM in all material respects.

Unqualified Audit Opinion

32. Our audit opinions on the financial statements and the regularity of transactions are unqualified.
33. No material audit adjustments were made to the financial statements during the audit. A small number of presentational and disclosure changes were agreed, none of which impacted on the net movement in the fund.

Financial Performance

34. SSNLDF incurred expenditure of £2.705m in 2008/09 and received income of £2.664m, including £2.427m from the National Lottery Fund. Included within the expenditure amount is a transfer to the Olympic Distribution Fund of £126,000.
35. This overall revenue outturn position resulted in a decrease in the fund of £41,000. SSNLDF reported a balance of £4.097m held with the National Lottery Distribution Fund as at 31 March 2009 (2008: £5.496m), and a net asset position of £2.994m (2008: £3.035m).

Outstanding Hard Commitments

36. At the end of the financial year SSNLDF had outstanding 'hard' (ie legally contracted) commitments of £1.280m. Included within this balance is a commitment to Bronco Films Limited (for "The Flying Scotsman") of £170,000. No payment was made in the current year and we are aware that there is an ongoing legal process as a result of the financial position of the film's production company.

37. SSNLDF consider it prudent to recognise a commitment at the year end within the financial statements given the current position. Whilst we concur with this treatment, we recommend that SSNLDF resolve this matter as soon as is possible.

Action Plan Point 1

Financial Management

38. SSNLDF has a responsibility to conduct its financial affairs in a proper manner. We are required to consider the arrangements for financial planning, budgetary control and financial reporting.
39. Budgets are devised at the start of the year, approved by the Board and then reviewed during the year to take account of any new information. Management accounts facilitate monitoring and review, and the cash position is also managed to ensure sufficient amounts are drawn down on a monthly basis to make award payments as they fall due. SSNLDF management adopt a prudent financial planning approach and continue to manage the fund's financial position effectively.

Future Plans

40. National Lottery receipts are projected to decrease because of funding being taking up by the London 2012 Olympic Games, both in terms of direct transfer to the Olympic Distribution Fund and through reduced non-Olympic ticket sales. Management have identified and continue to consider the impact this will have on the Lottery Fund, and have a balance of funds built up with the National Lottery Distribution Fund (NLDF) to support activity for 2009/10 and beyond.

International Financial Reporting Standards

41. Government departments and other public sector bodies will report using IFRS from 2009/10. In February 2009, we reported on our review of SSNLDF's 31 March 2008 IFRS-restated balance sheet. Since then, the Scottish Government has confirmed the IFRS transition timetable that SSNLDF will be expected to follow:
- 28 November 2008 – opening 2008 IFRS-based balance sheet to be presented to auditors for review (achieved).
 - 28 February 2009 – auditor review of opening balances to be completed (achieved).
 - 30 November 2009 – 2008/09 shadow IFRS-based financial statements to be completed.
 - 28 February 2010 – auditor review of 2008/09 shadow IFRS-based financial statements to be completed.

Action Plan

Our annual report action plan details the control weaknesses and opportunities for improvement that we have identified during 2008/09. These are the issues that we believe need to be brought to the attention of SSNLDF.

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.

Priority Rating

To assist SSNLDF 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:

- Grade 5 Very high risk exposure - Major concerns requiring Board attention.
- Grade 4 High risk exposure - Material observations requiring management attention.
- Grade 3 Moderate risk exposure - Significant observations requiring management attention.
- Grade 2 Limited risk exposure - Minor observations requiring management attention
- Grade 1 Efficiency / housekeeping point.

Issues arising from our 2008/09 audit

Title	Issue Identified	Risk and Recommendation	Management Comments
<p>Outstanding Hard Commitments</p> <p>(para 37)</p>	<p>Our review of outstanding hard commitments identified a balance of £170,000 to Bronco Films Limited ("The Flying Scotsman"). No payment was made in the current year and we are aware that there is an ongoing legal process as a result of the financial position of the film's production company.</p> <p>SSNLDF consider it prudent to recognise a commitment at the year end within the financial statements given the current position.</p>	<p>Continuing to recognise commitments unnecessarily could prevent the funds being invested in other projects.</p> <p>Whilst we concur with the treatment adopted by SSNLDF in this case, we recommend that the matter is resolved as soon as is possible.</p> <p>Grade 2</p>	<p>SSNLDF have adopted a prudent approach and continued to recognise the commitment to Bronco Films Limited in the 2008/09 financial statements. We are in ongoing discussions with the administrators regarding the financial position of the production company and will undertake a further review of the outstanding award in-year in order to come to a resolution. Any decision will then be presented to the Investment Committee.</p> <p>Responsible officer:</p> <p>Head of Business Affairs</p> <p>Implementation date:</p> <p>December 2009</p>

Follow up of issues from the 2007/08 audit

Title	Original Issue Identified	Original Management Comments	Update at July 2009
<p>Chief Executive Pay Award</p>	<p>In reviewing communications from the Scottish Executive (now Government) regarding the Chief Executive's 5% pay award, we noted reservations in relation to the measurability and assessment of performance.</p> <p>Further, at the time of the audit (June) the award had not been approved by the Scottish Government. Senior officers' pay is a politically sensitive issue and Scottish Screen should ensure that bonuses can be appropriately justified.</p> <p>In 2006/07 we recommended that the criteria against which the Chief Executive's pay award will be measured should be robust, and follow "SMART" principles (Specific, Measurable, Achievable, Relevant and Time-bound), as far as is possible. The Remuneration Committee should make a clear and comprehensive assessment of whether the performance against the criteria merits a bonus.</p> <p>Our 2007/08 update recommended that that the Remuneration Committee and Scottish Screen work with the Scottish Government Pay Policy Unit to prevent a similar situation from occurring in 2008/09.</p>	<p>As the CEO, the exercise of following 'SMART' principles is more difficult, as the nature of the role demands the setting and achievement of objectives which are challenging and intrinsically more subjective in interpretation and measurement.</p> <p>A concern would be that in meeting the requirement to set 'SMART' objectives, that the aspiration of the objective is lessened. This is a consideration that the Remuneration Committee will need to reflect upon moving forward in ensuring the Scottish Minister's comments are addressed.</p> <p>It should be noted that Executive guidance was followed in the submission of the CEO pay award and that there have been ongoing discussions with our Sponsor Department and Pay Policy with regard to this matter.</p>	<p>During 2008/09 a revised performance assessment process was introduced utilising an existing, effective review process established within another NDPB. This identified and weighted key performance areas and provided a clear scoring framework. This new process was adopted by the Remuneration Committee and while recognising the difficulties in setting and measuring 'SMART' objectives for a CEO, it allowed the Committee to measure the CEO's performance more objectively in key areas, leading to a more quantitative measure on which to make any performance award.</p> <p>At the time of the audit the bonus award has still not been approved by the Scottish Government. The issue is currently with the Sponsor Department and will be considered by the Remuneration Committee of the Scottish Government in due course. Scottish Screen is in contact with the Sponsor Department Officials to ensure this matter is dealt with on a timely basis.</p> <p><i>Further action required.</i></p>



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