Scott-Moncrieff

Scottish Screen National Lottery Distribution Fund

Annual Report to Creative Scotland and the Auditor General for Scotland 2009/10

September 2010

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Executive summary

Financial statements and use of resources

Our audit opinion on the truth and fairness of the Scottish Screen National Lottery Distribution Fund (SSNLDF) annual accounts and on the regularity of transactions is unqualified. The deadline for submitting final accounts will be achieved.

SSNLDF incurred expenditure of £3.810m in 2009/10 and received income of £2.925m, including £2.860m from the National Lottery Fund. This resulted in a decrease in the fund of £885,000. SSNLDF reported a balance of £3.285m held with the National Lottery Distribution Fund as at 31 March 2010, and a net asset position of £2.311m. A prior year adjustment has been made in the 2009/10 financial statements to reflect seven awards made in previous periods which were in fact Business Development Loans (BDL).

2009/10 was the first year that central government bodies were required to prepare financial statements under International Financial Reporting Standards (IFRS). We are pleased to report that the financial statements have been prepared in accordance with IFRS.

Performance

During 2009/10 a review of the lottery investment and award process was undertaken, resulting in changes to the investment strands in place. The revision reflects the changing needs of the sector, and making best use of the financial resources available. Management will continue to monitor the success of the investment strands, under the stewardship of Creative Scotland.

Governance

Creative Scotland became a Statutory Non Departmental Public Body (NDPB) on 1 July 2010, under the Public Services Reform (Scotland) Act. It replaces Scottish Screen and the Scottish Arts Council and has been established as a single body responsible for overseeing Scotland's arts and culture sector. Scottish Screen National Lottery Distribution Fund 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.

Scottish Screen and the Scottish Arts Council latterly operated under a Joint Board and related Committee structure, to facilitate a smooth transition to Creative Scotland. From January 2009 until the establishment of Creative Scotland, Scottish Screen and the Scottish Arts Council Boards held individual and joint meetings to allow management to focus on both individual organisational responsibilities as well as joint working arrangements.

During 2009/10 Scottish Screen worked towards the successful establishment of Creative Scotland, enabling the transition to take place in accordance with ministerial plans.

Looking forward

Creative Scotland has taken over the functions and resources of Scottish Screen and the Scottish Arts Council, as well as having a wider responsibility for developing the cultural sector as a whole. The transition to Creative Scotland will be accounted for as a Machinery of Government change. Interim abbreviated statements (operating cost statement, balance sheet and selective notes) for Scottish Screen and the Lottery Fund will have to be prepared for the intervening period 1 April 2010 to 30 June 2010 and included within the 2010/11 Creative Scotland accounts. Creative Scotland management, external audit and the Scottish Government are currently involved in agreeing the detailed requirements for this transition.

Conclusion

This report concludes the 2009/10 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 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 2010

Introduction

1. This report summarises the findings from our 2009/10 audit of Scottish Screen National Lottery Distribution Fund (SSNLDF). The scope of our audit was set out in our External Audit Strategy and Plan, which was presented to the Audit Committee at the outset of our audit.

2. The Auditor General has appointed Scott-Moncrieff as auditors of 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.

3. The main elements of our work in 2009/10 have been:

   - Our audit of the financial statements, including a review of the Statement on Internal Control
   - Review of the 2008/09 financial statements, restated under International Financial Reporting Standards (IFRS)
   - Review of governance arrangements, internal controls and financial systems

4. As part of our audit, we have also made use of the work of other bodies including the SSNLDF internal audit service.

5. We confirm that we have complied with relevant ethical standards over the course of our audit. In our professional judgement the audit process has been independent and our objectivity has not been compromised.

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

Financial statements and use of resources

Annual accounts and audit timetable

7. We are pleased to report that we received draft annual accounts and working papers of a high standard in line with the agreed timetable.

8. The annual accounts are due to be approved by the Creative Scotland Board on 8 September 2010 and submitted to the Scottish Government and the Auditor General for Scotland thereafter. The submission deadline of 31 October 2010 will be met.

9. During 2009/10 Scottish Ministers issued a revised Accounts Direction, which requires separate annual accounts to be prepared for the Lottery Fund. Scottish Screen is required to comply with the Financial Reporting Manual (FReM) when preparing its financial statements. We are satisfied that the SSNLDF 2009/10 accounts comply with the requirements of the FReM in all material respects.

Unqualified audit opinion

10. Our audit opinions on the financial statements and the regularity of transactions are unqualified.

11. During the course of the audit an adjustment was made to the financial statements to recognise the amounts receivable from Business Development Loans (BDLs) granted before 2009/10 but which have previously been accounted for as standard hard grant commitments. The impact of this adjustment is outlined below. A small number of presentational and disclosure changes were also agreed.

International Financial Reporting Standards (IFRS)

12. SSNLDF was required to prepare full IFRS-compliant financial statements for 2009/10. In January 2010 we undertook a review of the 2008/09 SSNLDF accounts, restated on an IFRS basis, and reported our findings and recommendations to the Audit Committee. The report confirmed that SSNLDF had successfully restated the 2008/09 financial statements, as required.

13. We are pleased to report that the 2009/10 financial statements have been prepared in accordance with IFRS.

Financial performance

SSNLDF incurred a reduction in fund of £0.885m during 2009/10, although a strong net assets position has been maintained

14. SSNLDF incurred expenditure of £3.810m in 2009/10 (2008/09: £2.826m[1]) and received income of £2.925m (2008/09: £2.624m). This includes income of £2.860m from the National Lottery Distribution Fund and expenditure of £0.503m by way of a transfer to the Olympic Distribution Fund.

15. The overall effect was a decrease in the Fund of £0.885m (2008/09: £0.202m). A balance of £3.285m was held with the central National Lottery Distribution Fund as at 31 March 2010 (2008/09: £4.097m), with a SSNLDF net asset position of £2.311m (2008/09: £3.196m).

16. The financial performance within the year reflects an increased level of commitments made. This included a number of high value commitments, such as £500,000 to BlueLight Neds Ltd and £400,000 to Sigma Films Ltd, both within the Content Production investment strand.

Audit adjustments

Adjustments were identified during our audit resulting in a reduction in operating income of £49,952

17. During our 2009/10 audit we identified that SSNLDF had issued Business Development Loans to seven organisations during 2007. The terms of these loans gave the recipient bodies two years to repay the amounts borrowed on an interest free basis. Thereafter, interest accrues at a rate of 3% with a maximum further two year repayment term.

18. These loans were originally recognised in the same way as standard hard commitments, with no balance sheet entry to reflect the receivable nature of the balance due back to SSNLDF.

19. During our audit we agreed with SSNLDF management that these loans should be re-classified by way of a prior year adjustment, and the amounts receivable have been recognised through the general reserve. The total amount outstanding on these loans as at 1 April 2009 was £207,935.

20. Repayments against the BDLs totalling £49,952 were received during 2009/10. This was initially recognised as income in the 2009/10 draft accounts. These receipts should instead have been applied directly against the outstanding receivables balance. This treatment has been agreed with management and reflected in the updated 2009/10 financial statements. Table 1 highlights the impact of this audit adjustment.

[1] Incorporates the impact of International Financial Reporting Standards

Table 1 – Adjustments during the audit

	2009/10 (£'000)
Deficit per original draft accounts	**(835)**
Adjustment to reflect recoupment of BDL	(50)
Final deficit position	**(885)**

21. International Accounting Standard 39 - *Financial Instruments: Recognition and Measurement* (IAS 39) requires the loan receivable to be discounted to fair value. The FReM stipulates that entities should use the higher of (i) the rate intrinsic to the financial instrument (in this case 3%) and (ii) the real discount rate set by HM Treasury (currently 3.5%). SSNLDF has applied the 3% rate, and has demonstrated that the impact of reverting to a 3.5% rate is negligible. We agree with this assessment and propose no audit adjustment on the basis of materiality.

22. Each of the BDLs was subject to scrutiny in 2007/08 under the SSNLDF investment decision-making process, through the Scottish Screen Investment Committee. We recommend that in future any new investment models should be reviewed by the Finance team to determine the correct accounting treatment.

Action plan point 1

SSNLDF should continue to monitor the outstanding BDLs for recoverability

23. IAS 39 also requires an organisation to assess, at each balance sheet date, whether there is any objective evidence that a financial asset has been impaired. This includes consideration of the recoverability of loans outstanding.

24. IAS 39 provides examples which indicate that the asset has been impaired, including the borrower experiencing financial difficulty or breaches of contract conditions. Whilst we do not disagree with the SSNLDF accounting treatment of the BDLs in the 2009/10 financial statements, we are aware that three of the organisations in receipt of BDLs have not repaid the loan within the initial term and are now in their second loan term, with interest now accruing. This may increase the likelihood of the loan not being repaid and which would therefore give rise to an impairment.

25. SSNLDF has been in regular dialogue with the three organisations and has concluded that adequate arrangements are in place to ensure that the loans will be fully recovered. We recommend that outstanding loan balances are formally reviewed on a periodic basis to confirm if there is any evidence of impairment.

Action plan point 2

Financial management

SSNLDF management adopt a prudent financial planning approach and have robustly managed the financial position

26. 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.

27. 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. Grant award commitments are recognised when there is an agreement in principle by SSNLDF to fund a scheme, rather than when a formal offer and acceptance has been agreed (hard commitment). This is a prudent approach to financial planning.

Performance

Organisational review

During 2009/10 SSNLDF revised the investment framework to reflect changing industry needs and the financial resources available

28. During 2009/10 the number of investment strands was reduced, with larger funds available for distribution within each strand. The aim was to increase access to funds whilst ensuring that the investment strands delivered against strategic objectives.

29. As a result of the review, a number of smaller investment strands have been incorporated into larger strands including the Short Film Fund, Express Film Fund and Pilot Fund being incorporated into the Content Production Framework. The Content Development Fund was also expanded to include a Seed Funding strand. Markets and Festivals were incorporated into the Opportunities Fund, which was also widened to include a Conferences, Seminars and Events strand. The Talent Development Fund was extended to include the Career Development Programme strand and the Market Development Fund now comprises two strands; Exploitation and Promotion.

30. Management will continue to monitor the success of the investment strands, under the stewardship of Creative Scotland.

Revised Investment Guidelines

31. 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.

Best Value

32. 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. Previously, the size and context of SSNLDF has meant specific and formal Best Value assessments were not undertaken. Rather, management looked to adopt Best Value principles as inherent in the day to day running of the organisation. Whilst this arrangement has until now been considered appropriate, with the move to Creative Scotland, and in recognition of the challenging financial environment, it would seem appropriate to consider whether more formal Best Value work could support optimising the efficiency and effectiveness of the new organisation. Management, external audit and internal audit could all play a role in taking this forward.

Governance

Creative Scotland

Successful transition to Creative Scotland

33. Following a review of the arts and creative sector in Scotland by the Cultural Commission, the then Scottish Executive announced that Scottish Screen and Scottish Arts Council would be replaced by a new body called Creative Scotland. Creative Scotland Ltd was established to facilitate the transition process. During 2009/10, Scottish Screen played an important role in the transition to Creative Scotland, as part of the wider 12 month transitional plan. Creative Scotland became a Statutory Non Departmental Public Body (NDPB) on 1 July 2010, under the Public Services Reform (Scotland) Act. It replaces Scottish Screen and the Scottish Arts Council and has established a single body responsible for overseeing Scotland's arts and culture sector.

34. A Joint Board for Scottish Screen and Scottish Arts Council was in operation during 2009/10, with the final meeting held in June 2010. On 11 June 2010 the Scottish Government announced the appointment of the first Chair and Board of Creative Scotland.

Accountable officer

35. Andrew Dixon was appointed Chief Executive Officer of Creative Scotland in May 2010. Given transition and reporting timescales, Andrew Dixon will be the Accountable Officer and will therefore sign the SSNLDF 2009/10 accounts as such. Ken Hay, Scottish Screen CEO during 2009/10, has provided formal assurances to the new Creative Scotland CEO to support him in signing the accounts.

Statement on Internal Control

36. 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. This is underpinned by a risk management framework sufficient and appropriate in the context of Scottish Screen.

Internal audit

37. Internal audit is a key component of Scottish Screen's corporate governance arrangements. SSNLDF's 2009/10 internal audit service was provided by Wylie and Bisset. We have considered the internal audit service and concluded that it 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

38. 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

39. 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.

Looking forward

Creative Scotland

From 1 July 2010 the powers as a National Lottery Fund Distributor transferred from Scottish Screen to Creative Scotland

40. Creative Scotland has taken over the functions and resources of Scottish Screen and the Scottish Arts Council, as well as having a wider responsibility for developing the cultural sector as a whole. The transition to Creative Scotland will be accounted for as a Machinery of Government change, avoiding potentially significant impact on the going concern assessment for the 2009/10 accounts. Interim abbreviated statements (operating cost statement, balance sheet and selective notes) for Scottish Screen will have to be prepared for the intervening period 1 April 2010 to 30 June 2010.

41. In June 2010 the National Lottery etc. Act 1993 (Amendment of Section 23) (Creative Scotland) Order 2010, was approved by Scottish Ministers. This transfers Scottish Screen's powers as a National Lottery Distributor to Creative Scotland from 1 July 2010.

42. At the time of our audit, senior management were in final stages of discussion with the Scottish Government over the specifics of recognising the transition to Creative Scotland within the financial statements. At time of writing, Creative Scotland management, external audit and the Scottish Government are involved in agreeing the detailed requirements for this transition.

Funding

The London 2012 Olympic Games continues to have an adverse affect on funding

43. 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. During 2009/10 SSNLDF transferred a total of £503,000 (2008/09: £126,000) to the Olympic Lottery Distribution Fund. The impact of the reduction in income has been incorporated into financial plans and is reflected within the revised investment framework.

44. Management continue to consider the impact on the Lottery Fund, and have a small level of funds built up with the National Lottery Distribution Fund (NLDF) to support activity for 2010/11 and beyond.

Action Plan

Our annual report action plan details the control weaknesses and opportunities for improvement that we have identified during 2009/10. 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.

Grading

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 grading 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 2009/10 audit

No	Title	Issue identified	Risk and recommendation	Management comments
1	**Business Development Loans** **(Para 22)**	During our audit we identified a number of funding arrangements which in substance represented loans rather than grant commitments. SS had accounted for these as standard commitments rather than loans.	Loans have been incorrectly accounted for in prior year financial statements – overstated in hard commitments and understated as assets.	BDLs are now correctly treated as an asset on the SSNLDF balance sheet. All repayments will be credited against the balance and any interest earned credited to the I&E account. In future any new investment models will be reviewed by the Finance team for accounting treatment and we will consult with the auditors for any specific technical advice. **Responsible officer:** Director of Finance and Operations **Implementation date: completed**

No	Title	Issue identified	Risk and recommendation	Management comments
2	**Recoverability of BDLs** **(Para 25)**	IAS 39 provides examples which indicate that a financial asset has been impaired, including the borrower experiencing financial difficulty or breaches of contracts. We are aware that three of the organisations in receipt of BDLs have not repaid the loan within the initial term and are now in the second term of the loan, with interest now accruing. Whilst the organisation has considered the recoverability of these loans, there is still a risk that the amounts may not be recouped.	There is a risk that the BDLs are not recognised in accordance with IAS 39 and impairments are not recognised appropriately. We recommend that outstanding loan balances are formally reviewed on a periodic basis to confirm if there is any evidence of impairment. **Grade 3**	As part of our ongoing management of investments we undertake reviews of the status of all projects. In respect of the BDLs regular reports are produced by the Business Affairs Manager for review by the Investment Committee. These reports specify the status of each investment and adherence to assigned payment schedules. This provides an effective alert mechanism for any deviation from agreed repayment plan. **Responsible officer:** Business Affairs Manager/Lottery Accountant **Implementation date:** ongoing/completed

Follow up of issues from the 2008/09audit

Title	Original issue	Original management comments	Update at July 2010
Outstanding Hard Commitments	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. SSNLDF consider it prudent to recognise a commitment at the year end within the financial statements given the current position. Continuing to recognise commitments unnecessarily could prevent the funds being invested in other projects. Whilst we concur with the treatment adopted by SSNLDF in this case, we recommend that the matter is resolved as soon as is possible.	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.	During 2009/10 the award to Bronco Films Limited was de-committed. We have reviewed outstanding hard commitments as at 31 March 2010 and confirmed to supporting evidence these represent genuine outstanding commitments. **Completed**

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