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Creative Scotland and Creative Scotland National Lottery Distribution Fund

Annual audit report to Creative Scotland

and the Auditor General for Scotland

Year ended 31 March 2012

28 September 2012

Contents

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

This report is for the benefit of Creative Scotland and Creative Scotland National Lottery Distribution Fund (together "Creative Scotland") and is made available to Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

We also draw your attention to the following:

- management of Creative Scotland is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems;
- weaknesses or risks identified by us are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist; and
- communication by us of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve Creative Scotland management from its responsibility to address the issues raised and to maintain an adequate system of control.

Executive summary

This is the second financial year of Creative Scotland, following implementation of the Public Services Reform (Scotland) Act 2010, resulting in the amalgamation of the Scottish Arts Council and Scottish Screen. Creative Scotland is a non-departmental public body ('NDPB') of the Scottish Government whose mission is '*to invest in Scotland's creative future'.*

Creative Scotland's objectives are to invest in:

- talent;
- quality artistic production;
- audiences, access and participation;
- the cultural economy; and
- places and their contribution to a creative Scotland.

The five objectives are aligned with the Scottish Government's National Performance Framework and contribute primarily to seven of the 15 national outcomes within the framework.

During 2011-12, Creative Scotland invested over £66 million across 1,270 projects and initiatives. This included the *Year of Creative Scotland*, investing in new art and cultural initiatives. The net operating cost for Creative Scotland for the year was £49.9 million, compared with £49.8 million drawn down in funding from the Scottish Government.

During 2012-13 Creative Scotland will continue the *Year of Creative Scotland* programme and management is also planning in 2012 to implement the London 2012 cultural programme in Scotland. There is significant investment planned in relation to National Lottery funding during for 2012 which will be distributed through grant awards to various bodies. Creative Scotland is also planning the implementation of new systems in 2012-13 covering customer relationship management, investment administration, HR and finance.

For the past six years, NLDF has made an Olympic transfer (£3.9 million in 2011-12) from the income allocation for each financial year. This transfer will cease in 2012-13, resulting in a substantial increase in available resources from 2013-14. Creative Scotland has reduced total expenditure by £6.6 million compared to 2010-11. Expenditure within NLDF has increased substantially by £12.1 million over the prior year.

A number of audit focus areas were identified as part of our planning process; no adjustments to the draft financial statements presented for audit were necessary in respect of those areas. Other, mainly presentational, adjustments were made to the financial statements, none of which had an impact on Creative Scotland's outturn or financial position.

We have completed our audit for 2011-12 and have issued unqualified audit opinions on the financial statements and the regularity of transactions included within the financial statements for Creative Scotland and Creative Scotland National Lottery Distribution Fund.

Headlines

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practise* ("the *Code*"). This specifies a number of objectives for our audit.

We reported, in our audit strategy, our responsibilities in respect of the audit. Creative Scotland's responsibilities are set out in appendix one.

This report summarises our work for the year ended 31 March 2012.

We wish to record our appreciation of the co-operation and assistance extended to us by Creative Scotland staff during the course of our work.

Financial statements	
Draft financial statements for Creative Scotland and Creative Scotland National Lottery Distribution Fund ("NLDF") were provided on 2 July and 25 June 2012, respectively, in line with the agreed timetable. These were primarily complete and of an appropriate standard. We have issued unqualified audit opinions on the 2011-12 financial statements and the regularity of transactions reflected in those financial statements.	-
Use of resources	
Total comprehensive expenditure for Creative Scotland for the year, after taking into account asset revaluations and actuarial losses on the Strathclyde Pension Fund was £49.9 million. Scottish Government funding was £49.8 million, giving a small deficit for the year of £44,000. Total comprehensive expenditure for NLDF was £26.3 million.	Pages 4 and 5
Creative Scotland met its financial targets through effective financial planning and management throughout the year.	Page 4
The 2012-13 budget anticipates a significant increase in investment expenditure levels, primarily financed through increased National Lottery funding.	Page 6
Governance	
There have been no significant changes during 2011-12 and the governance statement confirms the existence of a comprehensive framework of internal control. Internal audit completed their plan and made no significant risk recommendations during the year.	Page 13
Arrangements to prevent and detect fraud are embedded in internal controls.	Page 13
We have completed our work on the follow up of Audit Scotland's *Role of boards* report. Overall, we found that the board has recognised further work is required in some areas, particularly around performance management, and is seeking to continually improve its performance and ways of operating, including developing a performance management framework, ensuring effective systems are in place so that the board has the necessary skills and expertise to perform its functions.	-
During 2011-12 Creative Scotland developed a new corporate plan 2011-14: *Investing In Scotland's Creative Future*. This included three-year financial plans. Included within this is a planned reduction in funding through grant-in-aid, but an increase in National Lottery funded projects.	-

Financial position – Creative Scotland

Total comprehensive expenditure for 2011-12 was £51.5 million (*2010-11 £58.2 million*) against a Scottish Government grant of £49.8 million (*2010-11 £51.6 million*).

Grants, awards and investments relate to monies that are distributed by Creative Scotland in its role as a grant funding body. These are spent on a variety of programmes throughout Scotland that contribute to the cultural environment. In comparison to the prior year, there was a £3.9 million decrease in grants paid; this is primarily due to a decline in Scottish Government grant-in-aid in 2011-12 of almost £2 million. We have satisfactorily completed testing over the process and controls surrounding grant expenditure. This included testing a sample of grants for appropriate authorisation, selecting a sample of grants, awards and investments and vouching these the supporting documentation and performing cut-off procedures surrounding grant expenditure to ensure recognition in the correct financial period.

There has been a significant decrease in total staff costs due to the provision made in 2010-11 for additional contributions towards the Arts Council Retirement Plan (1994), staffing reductions and the voluntary severance scheme that operated in 2010-11. Only one payment was made towards severance in 2011-12, resulting in lower costs for the year. Other operating expenditure has decreased by £0.8 million from 2010-11; this reduction is due to transition costs associated with the amalgamation of Scottish Screen and the Scottish Arts Council not recurring in 2011-12. Other income has decreased by £1.0 million in 2011-12 due to funds for transition costs provided in 2010-11, not repeated in 2011-12.

Creative Scotland had one efficiency target in respect of 2011-12: delivery of 3% of efficiencies on operating expenditure levels compared to the prior year. This target was achieved. This target equated to £1.7 million of savings against 2010-11 expenditure levels and achievement reflects strong financial control and budget monitoring. The operating deficit reduced by £5.6 million, as shown in the table opposite, compared with 2010-11 (10.2%). The budget for 2011-12 reflected total expenditure of £50.7 million and forecast a small overspend (net of Scottish Government funding, project and other income); actual expenditure is in line with budgetary plans.

	2011-12 £'000	2010-11 £'000	Variance £'000
Project income	231	247	(16)
Other income	1,696	2,686	(990)
Total income	**1,927**	**2,933**	**(1,006)**
Staff costs	(3,894)	(5,821)	1,927
Depreciation	(174)	(210)	36
Project expenditure	(474)	(554)	80
Grants, awards and investments	(44,421)	(48,344)	3,923
Direct delivery expenditure	(860)	(747)	(113)
Other operating expenditure	(1,726)	(2,488)	762
Total expenditure	**(51,549)**	**(58,164)**	**6,615**
Interest receivable	1	2	(1)
Loss on disposal of asset	-	(6)	(6)
Other finance income/(costs)	65	36	29
Actual gain/(loss) arising on Strathclyde Pension Scheme	(384)	361	(745)
Capital grant net income	(30)	415	(445)
Net gain on revaluation	102	76	26
Total comprehensive net expenditure	**(49,868)**	**(54,374)**	**4,504**

Financial position – Creative Scotland National Lottery Distribution Fund

The Creative Scotland National Lottery Distribution Fund reported a significant increase in both income and expenditure in 2011-12 compared to the previous year. The former is a result of National Lottery Fund performance and Creative Scotland's share in that, while expenditure is considered to be a more accurate reflection of the level of business activities that Creative Scotland will have in future years. The change reflects the completion of the transition period following the amalgamation of Scottish Screen and the Scottish Arts Council.

National Lottery Fund proceeds have increased by £4.2 million in 2011-12 due to an increase in the share of income receivable by Creative Scotland and through increased ticket sales. This was consistent with the nature of the National Lottery Fund and the way in which it distributes funding depending on performance of the investment in the year.

Award commitments are recognised as expenditure when a commitment has been made to a body to provide funding. In 2011-12 there was a significant increase in award commitments, largely due to the system in awarding grants being significantly enhanced part way through 2010-11 and being fully operational throughout 2011-12. Award commitments in 2011-12 are considered more reflective of what will be expected as a typical year. We have completed detailed testing over the process and controls in place relating to award commitments and have substantively vouched expenditure to supporting documentation, while reviewing the classification of hard, soft and other commitments. Cut-off testing was completed to ensure commitments have been recognised in the correct accounting period. The results were satisfactory.

De-commitments are awards which were recognised as expenditure in a prior year, but have subsequently been withdrawn. This decreased in 2011-12 due to a particularly large de-commitment (£4.1 million) for a project which did not go ahead in 2010-11; there has been no de-commitment on a similar scale in 2011-12.

Until 2012-13, Creative Scotland has been required to process a transfer of a proportion of the National Lottery funding received back to fund the London 2012 Olympic Games. This transfer has now ceased, with the final transfer having been made on 1 August 2012. This is expected to result in NLDF having further funds to invest annually. The NLDF budget for 2011-12 estimated total income of £31.3 million and total expenditure of £31.7 million, estimating an overspend of £0.4 million, but this was amended in terms of expenditure during the course of the year to reflect changing circumstances around programme launches. The budgets also reflect all planned commitments, whereas the financial statements only include "hard" commitments.

	2011-12 £'000	2010-11 £'000	Variance £'000
National Lottery Fund proceeds	27,342	23,159	4,183
Other income	450	761	(311)
Total income	**27,792**	**23,920**	**3,872**
Award commitments	(20,218)	(12,939)	7,279
De-commitments	545	4,862	4,317
Project expenditure	(574)	(375)	199
Staff costs	(1,240)	(1,341)	(101)
Other operating expenditure	(951)	(498)	453
Transfer to Olympic Distribution Fund	(3,862)	(3,862)	-
Total expenditure	**(26,300)**	**(14,153)**	**12,147**
Total comprehensive net income	**1,492**	**9,767**	**(8,275)**

Financial position (continued)

The budget for 2012-13 anticipates a continuation of the move from grant-in-aid to National Lottery funding, but an overall increase in net expenditure levels compared to prior years.

	2012-13 Original budget total £'000	2011-12 Budget total £'000
Investments, awards projects	(92,297)	(75,329)
Direct delivery	(908)	(888)
Salaries	(4,304)	(3,815)
Other operating costs	(2,526)	(2,370)
Project overhead recovery	230	-
Total expenditure	**(99,805)**	**(82,403)**
Income	**91,555**	**81,981**
Outturn planned	**(8,250)**	**(422)**

The combined Creative Scotland and NLDF budget for 2012-13 anticipates expenditure of £99.8 million, with an outturn deficit of £8.2 million. This is in line with the £13.3 million balance in the general reserves of NLDF and, due to over commitments in lottery funding, aims to reduce the balance in the general reserves. This position is common among lottery funding distributors.

The 2012-13 budget includes a £9.6 million increase in resources. This his relates partly to the reduced Olympic transfer and also higher lottery ticket sales, based on National Lottery predictions. This increase in funding income is consistent with the corporate plan 2011-14.

A £16.9 million increase in investments, award projects is anticipated for 2012-13. This is mainly due to the a major drive on capital investment, with a budget of almost £38 million for 2011-14. This includes the Place programme (which is a large capital investment programme), the launch of which was delayed until the end of the financial year 2011-12 for allocation in 2012-13.   There is also a planned £5 million investment for the National Youth Arts Centre. These are consistent with the corporate plan 2011-14.

The 2012-13 payroll budget is increased by £0.5 million over 2011-12. This is calculated taking into account current staff levels and costs and planned recruitment. Assumptions include a 1% pay increase and a provision for the outcomes of the pay and grading review.

Audit focus areas

Audit planning risks were identified around pension assumptions, pension accounting, lease dilapidations, corporation tax, value added tax, financial reporting framework, commitments and opening balances.

No audit adjustments were required in respect of these areas and matters were concluded in a timely manner.

Issue	Key risk and implications (planning stage)	Audit approach and conclusion
Pension assumptions	Pensions accounting under IAS 19 requires actuarial input for 2011-12 movements on the Strathclyde Pension Fund. This will include the management's views on key assumptions which requires disclosure in the financial statements.	Our audit of the pension information within the financial statements has considered the actuarial assumptions used. We have compared these to KPMG's acceptable parameters by involving discussions on these assumptions with our internal pensions specialists. We confirm the assumptions used are within our acceptable ranges.
Pension accounting	Creative Scotland participates in two defined benefit pension schemes, the Strathclyde Pension Fund and the Arts Council Retirement Plan (1994). Although the Arts Council Retirement Plan (1994) is a defined benefits scheme, it is accounted for on a defined contribution basis following actuarial advice that the assets and liabilities cannot be separately identified.	A provision was recognised in the 2010-11 financial statements for Creative Scotland's liability in relation to the net present value of payments due under the recovery plan for the Arts Council Retirement Plan (1994). We have reviewed actuarial advice received against the requirements of IAS 19 Employee benefits and considered the treatment in the financial statements for appropriateness. We have reviewed the position at the year end in relation to the recovery plan and ensured it has been appropriately reflected in the financial statements.
Lease dilapidations	Creative Scotland holds three leases, each of which includes an obligation to cover any dilapidation and reinstatement costs as relevant at the end of the lease term. A provision was included on the balance sheet at 31 March 2011 in this respect.	We have reviewed the terms of each lease and the level of the provision included on the balance sheet to ensure the treatment is appropriate. No provision has been established for the property at Waverley Gate, Edinburgh. Management will consider this for the 2012-13 financial statements. We do not consider this omission to be material.

Audit focus areas (continued)

Issue	Key risk and implications (planning stage)	Audit approach and conclusions
Corporation tax	As a recently formed entity, Creative Scotland's corporation tax status is still being resolved; our corporation tax colleagues are currently working with management and HM Revenue and Customs to achieve this. There are two separate issues in relation to corporation tax: the transfer of funds and assets to Creative Scotland on formation; and the tax status of ongoing operations.	We have liaised with management and our tax colleagues prior to the year end and updated our understanding with relation to the corporation tax risk. We have ensured any tax liability is appropriately measured and reflected in the financial statements. A tax charge of only £35 was identified for the financial year 2011-12.
Value added tax ("VAT")	Creative Scotland's VAT status is also still being resolved. Management has prepared budgets and forecasts assuming VAT will be payable on all purchases (i.e. on a "worst case scenario"). Our indirect tax colleagues are working with management and HM Revenue and Customs to clarify the position.	We have liaised with management and our tax colleagues prior to the year end and ensured that indirect tax has been appropriately measured and reflected in the financial statements.
Financial reporting framework	Creative Scotland and NDLF prepare financial statements with regard to HM Treasury's Financial Reporting Manual ("FReM"). The 2011-12 FReM has a number of amendments from the 2010-11 version which management will need to consider for any impact on the reporting requirements and financial statements.	We liaised separately with management in advance of the year end audit visit and ensure changes to the FReM have been identified and then reflected in the financial statements. A number of changes were made to the financial statements disclosures following review during audit fieldwork to ensure completeness of reporting.
Commitments	NDLF recognises awards as liabilities when they meet the definition of "hard" commitments; "soft" or "other" commitments are disclosed in a note to the financial statements but are not reflected as liabilities. It is important that all commitments are monitored and tracked to ensure the amounts recorded and disclosed in the financial statements are complete. It is also important to ensure existence of balances in the financial statements (for example, to ensure older balances continue to represent liabilities).	We reviewed the processes for identifying and tracking commitments during our interim audit and have performed substantive testing around the balance during our year end audit visit, including consideration of hard versus soft / other recognition, to ensure commitments are appropriately reflected in the financial statements. We consider the current treatment in the financial statements to be appropriate.

Audit Scotland national reports

During 2011-12 we have performed follow-up work in relation to the Audit Scotland national report: *Role of Boards* as well as preparing returns on national studies.

Our work has found that Creative Scotland's arrangements are generally strong.

Audit area	Overview	Findings
Role of Boards	As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland has identified this report for follow-up in 2011-12. The aim of the follow-up work is to assess the progress that public bodies have made in seeking to improve the performance and operation of their boards. This will revolve around considering two key questions: ▪ how effective is the board and is it seeking to continuously improve its performance and ways of operating? ▪ how is the board ensuring that it has the skills and expertise to enable it to perform effectively?	Creative Scotland has been undertaking process of considering and actioning the issues raised within the Audit Scotland *Role of Boards* report. We have considered Creative Scotland's actions from the assessment as part of finalising our work for 2011-12 and will prepare a short return to Audit Scotland. Overall, Creative Scotland's evaluation indicates that further work is required to develop a framework for the management of the performance of the organisation, together with the identification of appropriate performance indicators consistent with the corporate plan and Creative Scotland's long term vision.

Performance management

Audit area	Overview	Findings
Best Value	Audit Scotland has been committed to extending the Best Value audit regime across the whole public sector for some time now. Using the Scottish Executive's nine Best Value principles as a basis for audit activity, Audit Scotland previously selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). A series of toolkits covering financial, performance and governance processes are available for public sector organisations and auditor to use. There is no mandatory requirement for toolkits to be applied in central government bodies in 2011-12. However, these are available to be used by management to self assess arrangements where considered relevant. We will consider management's arrangements to achieve Best Value during our interim fieldwork and will report our findings from this to the audit and risk committee.	Management has not utilised the Best Value toolkits, but a number of aspects of arrangements to deliver Best Value are effectively embedded into policies and practices. As part of the process of implementing the revised corporate plan and development of a performance reporting framework, appropriate measures of success are due to be identified. Management should consider using the Best Value toolkits as an aid to inform new policies, procedures or systems as they are developed. The overall approach to Best Value within the organisation could be formalised.
Priorities and risks framework	We use Audit Scotland's *priorities and risk framework* to extend the scope of our audit to consider non-financial management arrangements, identifying best practice and areas for continuous development.	As part of the audit planning process we met with management to update our understanding of non-financial management arrangements and utilised the priorities and risks framework as appropriate to inform our analysis of risks. We have no specific areas to report from this review, other than what is included elsewhere in this report.

Corporate governance framework and supporting arrangements

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Corporate governance and internal control arrangements **Standards of conduct and prevention and detection of corruption**	Creative Scotland maintains an integrated governance framework to provide an appropriate structure for maintaining decision-making, accountability, control and behaviour. Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively. However, during our interim review, we noted some minor weaknesses in respect of payroll, IT and journals; recommendations for improvement have been agreed with management. While processes and controls cannot ensure appropriate standards of conduct are maintained, we consider that processes in place reduce risks to an appropriate level; ongoing vigilance is also required.
Governance statement	The governance statement provides details of the purpose of the framework of internal control, along with an analysis of its effectiveness. It describes a number of sources of assurance for the accountable officer and identifies areas for improvements to be focussed on in the future. We have reviewed the governance statement and have confirmed that it is in line with guidance and reflects our understanding of Creative Scotland.
Internal audit	As set out in our audit plan and strategy, we have evaluated the work of internal audit and concluded that we can rely, where appropriate, on their work. The content of the internal audit plan is, in our view, comprehensive. We have considered internal audit reports during our audit and there were no significant issues that have arisen as a result of these reviews. Internal audit have reported 'that Creative Scotland generally has an adequate framework of control over the systems examined during the year (covering performance management, investment administration, financial controls framework, human resources best practice and implementation follow up), subject to implementation of outstanding recommendations.
Prevention and detection of fraud	Procedures and controls related to fraud are designed and implemented effectively. There is a whistleblowing policy that can be found on the Creative Scotland intranet. During the year, internal audit investigated a reported external fraud at Creative Scotland. This was reviewed and action taken. A full report was submitted by internal audit to the board's audit and risk committee and to the Scottish Government. An action plan was agreed and implemented during the year to minimise the risk of a similar fraud occurring in future.

Appendix

Audit Scotland code of audit practice – responsibilities of Creative Scotland

Financial statements

Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice);
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions;
- developing and implementing strategies to prevent and detect fraud and other irregularity;
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and
- participating, when required, in data matching exercises carried out by Audit Scotland.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers;
- promoting appropriate values and standards; and
- developing, promoting and monitoring compliance with standing orders and financial instructions.

Audit Scotland code of audit practice – responsibilities of Creative Scotland (continued)

Financial position

Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and future use; and
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

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