



cutting through complexity

Creative Scotland and Creative Scotland National Lottery Distribution Fund

Annual audit report

Audit: year ended 31 March 2013

14 November 2013

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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 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.

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

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance*, this report also summarises our work in relation to the financial statements for the year ended 31 March 2013.

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

Area	Summary observations	Analysis
Service overview		
Business issues and financial position	<p>Expenditure for both Creative Scotland and the Lottery Fund increased in 2012-13, although the planned utilisation of Lottery Fund reserves did not materialise due to the timing of project expenditure being behind forecasts. The Creative Scotland result for the year includes a £0.6 million charge following revaluation of property, plant and equipment.</p> <p>There were a number of departures from the senior management team including the chief executive, one creative director and the director of finance. Following significant negative publicity, the board made a number of public commitments to change to improve consistency in dealings with funded bodies and partner organisations.</p>	Page 4
Performance Management		
Performance management	As reported in the prior year, Creative Scotland's performance management arrangements have significant scope for improvement. During the year, management established a corporate knowledge and planning team with a view of establishing a more robust framework, including relevant key performance indicators.	Page 7
Governance and narrative reporting		
Governance	Our review of governance arrangement did not identify any issues. There were a number of changes in senior management during the year which are reflected in the governance statement. We did not identify any areas requiring revised disclosures during our audit.	Pages 11, 12
Control observations	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are in the main designed appropriately and operating effectively. We reported on control weaknesses in our interim management report	
Financial statements and accounting		
Accounting policies	There have been no changes to accounting policies in 2012-13. No newly effective accounting standards are expected to have a material impact on next year's financial statements.	Page 13
Audit conclusions	We have issued unqualified audit opinions on the 2012-13 financial statements.	Page 15
Year-end process	The financial statements were received by the agreed date and were well supported by high quality working papers, but the management commentary and remuneration report were received after our on site audit work had completed.	Page 15

Service overview

Our perspective on Creative Scotland's key business issues and financial position

Creative Scotland's total comprehensive expenditure for 2012-13 was £53.6 million (2011-12 £51.5 million) against a Scottish Government grant of £51.2 million (2011-12 £49.8 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.

During 2012-13, Creative Scotland invested over £45 million across 900 projects and initiatives. The net operating cost for the year was £52.7 million, compared with £51.2 million drawn down in funding from the Scottish Government. Creative Scotland has increased total expenditure by £2.8 million compared to 2011-12. The statement of comprehensive net expenditure reflects a charge of £0.6 million in relation to the downwards revaluation of property, plant and equipment.

We have completed testing over the process and controls surrounding grant expenditure with no significant deficiencies to report. This included testing a sample of grants for appropriate authorisation, vouching a sample of grants, awards and investments to supporting documentation and performing cut-off procedures surrounding grant expenditure to ensure recognition in the correct financial period.

As in prior years, Creative Scotland had one efficiency target in respect of 2012-13: delivery of 3% of efficiencies on operating expenditure levels. This target was achieved. The target equated to £1.7 million of savings against 2010-11 expenditure levels and has been built into underlying budgets since 2011-12.

The deficit for the year reduced by £2.3 million, as shown in the table opposite, compared with 2011-12 (5%). The budget for 2012-13 reflected total expenditure of £50.7 million and forecast a small overspend (net of Scottish Government funding, project and other income); actual expenditure was broadly in line with budgetary plans.

	2012-13 £'000	2011-12 £'000	Variance £'000
Project income	202	231	(29)
Other income	2,086	1,696	390
Total income	2,288	1,927	361
Staff costs	(4,078)	(3,894)	(184)
Depreciation	(249)	(174)	(75)
Project expenditure	(498)	(474)	(24)
Grants, awards and investments	(45,891)	(44,421)	(1,470)
De-commitment of awards	139	-	139
Direct delivery expenditure	(766)	(860)	94
Other operating expenditure	(2,237)	(1,726)	(511)
Expenditure	(53,580)	(51,549)	(2,031)
Interest receivable	1	1	-
Impairment of PPE	(580)	-	(580)
Other finance income/(costs)	41	65	(24)
Deficit for the year	(51,830)	(49,556)	(2,272)

Source: financial statements.

The Lottery Fund reported a significant increase in both income and expenditure in 2012-13 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.

National Lottery Fund proceeds have increased by £7.3 million in 2012-13 due to an increase in the share of income receivable by Creative Scotland and through increased ticket sales. This reflects the nature of the National Lottery Fund and the way in which it distributes funding depending on performance of the investment.

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 the Lottery Fund having further funds to invest annually.

Award commitments are recognised as expenditure when a commitment has been made to a body to provide funding. There has been significant increase in award commitments in 2012-13, which is £7.7 million higher than 2011-12 (which was £7.3 million higher than 2010-11).

The increase in award commitments was planned and in line with the corporate plan 2011-14. Award commitments in 2012-13 are considered more reflective of what will be expected as a typical year going forward. 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 with no significant deficiencies to report.

De-commitments are awards which were recognised as expenditure in a prior year, but have subsequently been withdrawn. This decreased in 2012-13 due to a particularly large de-commitment (£500,000) for a project which did not go ahead in 2011-12; there has been no de-commitment on a similar scale in 2012-13.

	2012-13 £'000	2011-12 £'000	Variance £'000
National Lottery Fund proceeds	34,638	27,342	7,296
Other income	1,023	450	573
Total income	35,661	27,792	7,869
Award commitments	(27,911)	(20,218)	7,698
De-commitments	74	545	(471)
Project expenditure	(1,696)	(574)	(1,122)
Staff costs	(1,602)	(1,240)	(362)
Other operating expenditure	(1,013)	(951)	(62)
Transfer to Olympic Distribution Fund	(1,799)	(3,862)	2063
Total expenditure	(33,947)	(26,300)	(7,647)
Total comprehensive net income	1,714	1,492	222

Source: financial statements.

The Lottery Fund budget for 2012-13 reflected total income of £39.2 million and total expenditure of £45.4 million, so that cumulative reserves were utilised. The budget was amended during the year to reflect changing circumstances around programme launches. The budgets reflect all planned commitments to ensure visibility and also retained reserves from the prior year; the statement of comprehensive net expenditure includes only "hard" commitments and income receivable in year. The planned overspend did not arise due to changes in the timing of expenditure and commitment of projects.

The budget for 2013-14 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.

Financial plans for 2013-14

The combined Creative Scotland and Lottery Fund budget for 2013-14 anticipates expenditure of £111.9 million, with an outturn deficit of £14.6 million. This is in line with the plan to utilise the £15 million balance in the general reserves of Lottery Fund and, due to over commitments in lottery funding. Management believes this position is common among lottery funding distributors.

The 2013-14 budget includes a £5.8 million increase in resources. This relates partly to the end of the 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.

Expenditure on investments, awards and projects is anticipated to significantly increase again (by £11.9 million) in 2013-14. This is mainly due to the continuing drive on capital investment, with total budget of almost £38 million included in the 2011-14 corporate plan. This includes the Place programme (which is a large capital investment programme) the launch of which was delayed from financial year 2011-12 and commenced in 2012-13.

	2013-14 budget total £'000	2012-13 Original budget total £'000
Investments, awards and projects	(104,217)	(92,297)
Direct delivery	(923)	(908)
Salaries	(4,332)	(4,304)
Other operating costs	(2,644)	(2,526)
Project overhead recovery	230	230
Total expenditure	(111,885)	(99,805)
Income – Creative Scotland	53,149	52,380
Income – Lottery Fund	44,183	39,175
Total income	97,332	91,555
Outturn planned	(14,554)	(8,250)

Performance management

Our perspective on the performance management arrangements, including follow up work on Audit Scotland reports

Management have responded to the Director General, Governance and Communities letter on corporate expectations.

<p>Performance management</p>	<p>In our 2011-12 annual audit report we stated that there was scope for enhancing performance management arrangements and that management was working to do this. This was recognised by the board and its audit committee and also by conclusions and recommendations from internal audit who performed a review of performance management during the year, concluding that current processes are limited and fragmented. This remains an area of weakness within the organisation with a framework still to be implemented.</p> <p>Management established a corporate knowledge and planning team during the year to help establish a more robust performance framework. As part of this work, a set of key performance indicators ('KPIs') is being developed which will be included in budgets and operational plans. These KPI's will be aligned to Creative Scotland's strategic objectives and will therefore allow management to monitor achievement of those objectives.</p>
<p>Best Value</p>	<p>In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure there are arrangements designed to secure Best Value. Audit Scotland is committed to extending the Best Value audit regime across the whole public sector. 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).</p> <p>Management have not utilised the Best Value toolkits, but considers that a number of aspects of arrangements to deliver Best Value are effectively embedded into policies and practices. For example, management participate in the procurement capability assessment exercise and have previously improved their rating under this assessment from 26% at March 2012 to 38% at October 2012.</p> <p>There may be opportunities for Creative Scotland to improve its practices by adopting other principles from Best Value toolkits, including in relation to performance management. Accordingly, we consider that management should review the use of the toolkits to identify areas of potential improvement in current processes.</p> <p>In 2012-13, Creative Scotland had a 3% efficiency saving target, equating to £1.7 million compared with 2011-12. This target was achieved in the year. In respect of 2013-14 a 3% efficiency target has again been set.</p>
<p>Corporate expectations</p>	<p>The Director General, Governance and Communities wrote to public bodies on corporate expectations in July 2012 asking for a preliminary assessment of progress. This was considered by management and a response was submitted to the Scottish Government in November 2012.</p> <p>This confirms that management is acting to fulfil the various corporate expectations with details of achievements to date and future actions. It identifies a number of areas where further progress is required and is currently ongoing including renewing the corporate plan, performance management and implementation of new IT systems that are fit for purpose.</p> <p>Management also participated in a meeting with a number of other public sector bodies in relation to responses to this letter to discuss best practices. We consider management's actions in response to the Scottish Government's letter to be appropriate.</p>

During 2012-13 we have performed follow-up work in relation to the Audit Scotland national report: *Scotland's public finances: Addressing the challenges* as well as preparing returns on national studies. In our opinion, while Creative Scotland has reasonable overall processes in place for setting budgets and monitoring performance, there is scope for improvement.

Scotland's public finances: addressing the challenges

As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland has identified the *Scotland's public finances: Addressing the challenges* for follow-up by local auditors in 2012-13. The aim of the follow-up work is to assess how public bodies are responding to the challenges of public sector budget constraints and their efforts to achieve financial stability.

In our opinion, Creative Scotland has a reasonable budget setting and review processes with evidence of senior management team involvement and challenge throughout the process. There are however, opportunities to improve the process; the Lottery Fund budget for 2012-13 reflected a significant deficit which did not materialise. We believe there is the opportunity to reconsider assumptions around the timing of expenditure and commitment of projects to ensure the reliability of budgets.

The 2013-14 budget was produced on a 'zero-based' basis taking into account input from all budget managers and the senior management team. Variances and delivery against budget are monitored on a monthly basis. The budget for 2013-14 is included in the recently published annual plan which sets out expenditure and anticipated awards in detail. Management is planning to complete a longer term corporate plan during 2013-14 which will link to the action plan for change which was published in March 2013.

The 2013-14 budget has been set incorporating savings required to respond to the reduction in Scottish Government grant funding and the 3% efficiency target which has been built into budgets since 2010-11. Detailed findings are given in appendix three.

Governance and narrative reporting

Our overall perspective on your narrative reporting, including the remuneration report and annual governance statement

Update on controls findings from our audit

We updated our understanding of the governance framework and did not identify any issues in relation to governance.

<p>Annual governance statement and governance arrangements</p>	<p>The statement for 2012-13 outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements and analyses the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer. There was considerable negative publicity on Creative Scotland during the year which resulted in the board making a number of commitments to change in December 2012. The previous chief executive left the organisation in January 2013 and was replaced in July 2013, with an existing director acting as chief executive in the intervening period.</p> <p>The changes in chief executive during the year resulted in changes in accountable officer, initially to the interim chief executive and then to the new chief executive in July 2013. The result is that the government statement is signed by an accountable officer who was not in place during the 2012-13 financial year. In addition to the change in chief executive, one of the three creative directors resigned during the year and the director of finance resigned in March 2013.</p> <p>The statement, which is made by the accountable officer, considers the effectiveness of the system of internal control based on assurances provided by the senior management team. The statement identifies that there have been no significant risk-related matters and no significant lapses of data security.</p> <p>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. As part of our interim audit we updated our understanding of the governance framework as part of our overall assessment of Creative Scotland's risk and control environment. We did not identify any issues during our interim review. We also considered this as part of our work on the annual governance statement and again did not identify any issues.</p>
<p>Annual report, including the management commentary</p>	<p>The financial statements form part of the annual report of Creative Scotland and the Lottery Fund for the year ended 31 March 2013. We are required to consider the management commentary and provide our opinion on the consistency of it with the financial statements.</p> <p>Management has reconsidered the management commentary in 2012-13 and changed the context to make it more concise and to clarify the links to the financial statements. In our view this has enhanced the annual report and made it clearer to the reader.</p> <p>We are satisfied that the information contained within the management commentary is consistent with the financial statements.</p> <p>Changes to the UK Corporate Governance Code, which will be applicable for year ending 31 March 2014, will require that the 'front end' narrative reporting of relevant financial statements is 'fair, balanced and understandable.' This may be applicable to Creative Scotland if applied by the FReM.</p> <p>If Creative Scotland is required to comply with the UK Corporate Governance Code, there may be changes to the format and content of our audit opinion. If required, we recommend early consideration of the requirements of the revised Code against Creative Scotland's reporting format.</p>

Remuneration report	<p>The information for the remuneration report was provided during our on site audit visit, and supported by good quality information to support the disclosures provided, although the report was not available at this point. A number of amendments were made to the remuneration report to ensure disclosures related to senior departures during the year were complete and accurate.</p>
Internal audit	<p>We have considered the findings from internal audit reports finalised during 2012-13 to inform our assessment of risks that need to be considered and addressed during the audit. Our review of internal audit reports also helps ensure that any duplication of work is avoided. The internal audit provider changed during the year following a competitive tender.</p> <p>Internal audit reported that Creative Scotland has in place a framework of governance, risk management and control, including operational financial and ICT controls, that provides reasonable assurance regarding the effective and efficient achievement of the organisations objectives.</p>
Prevention and detection of fraud	<p>Procedures related to fraud are designed and implemented effectively.</p> <p>There is a whistle blowing policy that can be accessed by staff on the Creative Scotland intranet. No significant fraud or irregularity has been identified during the year.</p>
National Fraud Initiative (“NFI”)	<p>The National Fraud Initiative (“NFI”) is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches. This is the first time Creative Scotland has participated in the NFI process.</p> <p>Creative Scotland has received the data matches back and have made progress in commencing investigations. Based on progress made to date, Creative Scotland’s arrangements for the investigation of NFI matches appear sufficient with an update provided to the March audit committee. We will complete an NFI questionnaire which will be reported to Audit Scotland by 31 January 2014. This will be completed in liaison with management.</p> <p>At this stage, we are satisfied with the progress that has been made.</p>

Financial statements and accounting

Our perspective on the preparation of the
financial statements and key accounting
judgements made by management

There have been no changes to accounting policies in 2012-13. All accounting policies have been applied consistently.

There have been no substantive changes to the financial reporting framework as set out in the Government's *Financial Reporting Manual* ("FReM").

The financial statements have been prepared on a going concern basis.

Accounting framework and application of accounting policies	
Area	KPMG comment
Financial reporting framework	<ul style="list-style-type: none"> ■ Creative Scotland prepared the financial statements in accordance with the Government's Financial Reporting Manual 2012-13 ("FReM"). ■ During the year there have been no substantive changes in financial reporting requirements, and consequently there are no material changes to Creative Scotland or the Lottery Fund's accounting policies. ■ We are satisfied that the accounting policies adopted remain appropriate to Creative Scotland.
Impact of revised accounting standards	<ul style="list-style-type: none"> ■ No newly effective accounting standards are considered to have a material impact on Creative Scotland's financial statements.
Going concern	<ul style="list-style-type: none"> ■ The financial statements have been prepared under the assumption that Creative Scotland and the Lottery Fund are going concerns. Given the nature of both, this is a reasonable assumption and budgets have been set for 2013-14 which indicate that the organisations will continue to operate.

We have issued unqualified audit opinions on the financial statements and the regularity of transactions reflected in those financial statements.

The financial statements were made available on a timely basis and were accompanied by high quality working papers.

Audit conclusions

Our audit work is complete and we have issued unqualified opinions on the truth and fairness of the state of Creative Scotland and the Lottery Fund's affairs as at 31 March 2013, and of the financial statements for the year then ended. We have also provided unqualified opinions on the regularity of transactions within the year. There are no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks;
- liaised with internal audit and reviewed their reports to ensure all key risk areas having a potential financial statements impact have been considered;
- reviewed assumptions and judgements made by management and considered these for appropriateness;
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to prevention and detection of fraud with the potential to impact on the financial statements; and
- attended the audit committee to communicate our findings to those charged with governance, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

Financial statements preparation

- High quality working papers and draft financial statements were provided at the start of the audit fieldwork in May 2013 but this excluded the management commentary and remuneration report.
- In advance of our audit fieldwork, we issued a 'prepared by client' request setting out a list of required analyses and supporting documentation. The standard of documentation was good and there was evidence of accountability and ownership of working papers across the finance department.
- During the year we had correspondence with the finance team to ensure that disclosure within the financial statements was consistent with the requirements of the FReM. We provided feedback to management on the content of the financial statements, annual report and remuneration report, and report that these were consequently prepared appropriately.
- Management alerted us to the issue in relation to valuation of property plant and equipment refer to page 16 in advance of the audit allowing early consideration and resolution within the agreed audit timetable.
- There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content.

We reviewed key judgements in relation to the accounting for property, plant and equipment and retirement benefits.

Overall, in respect of the key judgements made in the preparation of the financial statements, we are satisfied that management's judgements are generally balanced, and do not represent either an overly optimistic, or overly cautious, position.

Assessment of subjective areas	
Asset/liability class	KPMG comment
Property, plant and equipment	<p>Creative Scotland owns a property at 346-354 Sauchiehall Street, Glasgow and accounts for this as property, plant and equipment ("PPE") on the balance sheet. The FReM requires that this is recorded at fair value and this is satisfied through performing a full valuation every five years with an interim valuation in year three. Such a valuation was required at 31 March 2013 and was undertaken by an external surveyor. This valuation resulted in a significant diminution in value (£1.7 million) which management then sought to investigate. It was identified that £0.7 million of this related to market movements in property values and £1 million related to a difference in the accounting in Creative Scotland's balance sheet on formation in respect of the transfer of this asset from the Scottish Arts Council. The result of this is that the PPE on the balance sheet has been overstated by around £1 million since formation.</p> <p>Management considered how to reflect the impact of the revaluation in the financial statements in line with the FReM and IFRS. It was concluded that this is not material and accordingly reflected the adjustment through the 2013 balances. The impact of this adjustment was a charge of £0.6 million to the statement of comprehensive net expenditure and a charge of £1.1 million to the revaluation reserve. Having considered management's work in this area, we believe this is reasonable.</p>
Retirement benefits accounting	<p>Creative Scotland accounts for its participation in the Local Government Pension Scheme ('LGPS') in accordance with IAS 19 <i>Retirement benefits</i>, using a valuation report prepared by actuarial consultants. Our audit of the accounting for retirement benefits includes consideration of the data underlying the actuarial report. This includes primarily the level of contributions made by the group in the year and the financial assumptions.</p> <p>The level of contributions made by the group in the year is estimated based on data prior to the year end. It is important that this number is accurate as it is used to inform the pensions calculations at the year end. Our testing included reconciliation of this data at the year end. No issues were identified.</p> <p>The actuaries use a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to discount the anticipated future liabilities back to the year end date. IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA) corporate bonds of equivalent term to the liabilities. Our actuarial colleagues have reviewed the assumptions and concluded that those used fall within the range that we consider acceptable for a typical LGPS employer (with a liability duration of around 17 years).</p>

Appendices

There were no changes to the core financial statements and one unadjusted difference, the most likely difference in the financial statements.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	<p>There were no audit adjustments required to the draft financial statements which impacted on the net assets or the net expenditure for the year.</p> <p>A number of minor numerical and presentational adjustments were required to some of the financial statements notes and narrative statements.</p>	-
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	<p>We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you.</p> <p>There are no unadjusted differences.</p>	-
Confirmation of Independence Letter issued by KPMG to the Audit Committee	<p>We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Director and audit staff.</p>	Appendix two
Schedule of Fees Fees charged by KPMG for audit and non-audit services	<p>During 2012-13 we performed non-audit services in relation to a grant report for Media Antenna; the fees for this were £1,500.</p>	-
Draft management representation letter Proposed draft of letter to be issued by Historic Scotland to KPMG prior to audit sign-off	<p>There are no significant changes to the standard representations required for our audit from last year.</p>	-

Auditing Standards require us to consider and confirm formally our independence and related matters in our dealings with the Agency.

We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.

Auditor independence

Professional ethical standards require us to provide to you at the conclusion of an audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by the Company and its related entities for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Regular communications
- Internal accountability
- Risk management
- Independent reviews

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Chief Executive.

Confirmation of audit independence

We confirm that as of 14 November 2013, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland has identified Scotland's public finances: Addressing the challenges for follow-up in 2012-13.

We carried out follow-up work to consider Creative Scotland's response to the report.

1. Do public bodies have sustainable financial plans which reflect a strategic approach to cost reduction?

Does the organisation have a balanced financial plan for 2012-13 which sets out:

- Assumptions about sources of income and cost pressures?
- What cost reductions and other efficiency savings will need to be made, and how they are to be delivered?
- Risks to service delivery as a consequence of the need to reduce costs and deliver identified efficiency savings?

The question relates to 2012-13 but as this return is been completed in 2013-14 and answers primarily relate to 2013-14 onwards.

Management has produced a combined budget including both Creative Scotland and the Lottery Fund. The combined budget reflects an overspend of £14.6 million which relates to utilisation of Lottery Fund reserves. A deficit was also planned in 2012-13 but did not materialise due to changes in the timing of expenditure and commitment of projects. We believe there are opportunities to reconsider assumptions around the timing of commitments to ensure the budget is produced accurately.

Cost reductions and efficiencies have been built into budgets since 2011-12 and therefore meeting the budget for the year ensures savings and efficiencies are realised.

Service delivery is not anticipated to be impacted as the current corporate plan 2011-14 took into account expected savings requirements.

Does the organisation have a clear budget-setting process which:

- Demonstrates a clear understanding of its costs and how costs vary with activity?
- Takes into account previous years' service delivery performance and where improvements need to be made?
- Takes into account the body's track record on delivering against budgets and analysis of the reasons for previous years' under/over spends?
- Allocates resources according to a clear understanding of its priorities, including which services or activities are expected to contribute most and least to the achievement of the organisation's outcomes?

Creative Scotland has a clear budget setting process led by the finance team. Creative Scotland's expenditure is primarily related to grants and other awards to organisations in the creative industries and is therefore directly linked to funding commitments.

Previous years' service delivery is taken into account in establishing the budget which is then reviewed during the year. Movements in the 2012-13 budget were primarily related to reprofiling of awards which are only made once organisations meet certain commitments. Expenditure in the Lottery Fund was significantly below budget due to this reprofiling and management has therefore sought to improve the process for 2013-14.

The budget setting process for 2013-14 utilised a 'zero-based' approach which involved all directors and budget managers. Resource allocation is primarily through approval of individual projects which are agreed in line with strategic objectives.

1. Do public bodies have sustainable financial plans which reflect a strategic approach to cost reduction? (continued)

Is there a clear evidence base to cost reduction plans? If yes:

- Does the organisation undertake a programme of service reviews designed to identify the scope to reduce costs?
- Do cost reduction plans provide adequate detail on how savings are to be made and over what timeframe?
- Do cost reduction plans state who within the organisation is accountable for their delivery?
- Do cost reduction plans give adequate consideration to the impact of reduced expenditure/ changes to service delivery arrangements on service performance and outcomes?
- Are clear baselines established against which efficiency savings can be measured?

Management put in place plans to meet the required efficiency savings in 2011-12, ahead of Scottish Government requirements. Cost reductions were identified following the formation of the organisation and as part of creating initial structures and processes. Efficiency savings were based on the 2010-11 financial outturn.

Budgets are produced with a view to delivering the corporate plan in terms of service performance. While operational cost savings are embedded in budgets, grant and award funding levels are increasing due to increased Lottery Fund resources.

Does the organisation regularly use benchmarking to compare its costs and performance with other organisations, including public bodies in other sectors and other non-public sector bodies?

Can the organisation demonstrate real and measurable benefits from its benchmarking activities in terms of cost and/or quality improvements?

Creative Scotland does not currently use benchmarking for financial such purposes. Management is currently identifying a number of KPIs which will be reported for 2013-14 and which will be able to be benchmarked against other organisations.

1. Do public bodies have sustainable financial plans which reflect a strategic approach to cost reduction? (continued)

Does the organisation have a longer term financial strategy which:

- Takes into account planned changes to service delivery arrangements and anticipated changes in demand for services?
- Sets out how financial resources will be matched to strategic goals?
- Demonstrates that current cost reductions and efficiency savings are in line with longer term strategic objectives?

There is no specific long term financial strategy document. The financial strategy is driven by the corporate plan with the existing plan covering the period from 2011 to 2014. This has detailed analysis of the budgets for 2011-12 to 2013-14. This also details how service delivery costs were significantly reduced on formation of Creative Scotland.

An updated longer term plan is currently being developed which management anticipates will identify links between financial resources and strategic goals.

2. Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?

Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans:

- Are high level financial targets and the overall financial position of the organisation discussed regularly at board level meetings?
- In setting financial plans, do members adequately consider the impact of budget reductions on service quality and outcomes?

The budget is subject to review and approval by the board prior to finalisation. The 2013-14 was initially reviewed by the board in March 2013 and was finalised and approved in April 2013. Papers and minutes indicate appropriate scrutiny of these areas by the board.

Do senior officials, elected members and non-executive directors provide:

- Sufficient focus on strategy and performance?
- Adequate challenge on longer-term financial plans?
- Regular consideration of financial risks?
- Adequate monitoring of the achievement of efficiency targets?

The senior management team regularly reviews performance against budgets. There is no specific long term financial plan but the senior management team do provide challenge in the annual budget setting process.

Financial risks are considered by the senior management team and budget holders in the form of the monthly reports against budget which are provided to the board. Achievement of the 3% efficiency saving is also reported to the senior management team.

2. Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval? (continued)

Is there appropriate transparency and accountability of decisions about cost reduction measures and future organisational plans:

- Is there appropriate consultation with the public and other stakeholders over cost reduction plans which identify various options and their impact on service delivery and outcomes?
- Do financial and corporate plans adequately spell out the consequences of reduced budgets on the organisation's ability to deliver services and outcomes?

Creative Scotland has not consulted with the public and other stakeholders over cost reduction plans although there was a consultation with stakeholders in respect of the annual plan. Changes in the delivery model for elements of funding resulted in negative publicity during the year. An annual plan was recently published and a longer term plan will be developed during 2013-14 taking into account input from recent open sessions with stakeholders. No specific reference is made to reduced budgets in the annual plan, although the existing corporate plan 2011-14 gives an indication of how reduced budgets have been managed.

2. Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval? (continued)

Do finance/resource committees and other scrutiny committees play a suitably prominent role in the consideration of budget plans and risks to service delivery:

- Are finance/resource and other scrutiny committees sufficiently involved in the consideration of budget plans, including:
 - the impact of budget reductions on service delivery
 - the organisation's track record of delivering against budgets?
 - reasons for previous years' under/over spends against budget?
- Do finance/resource and other scrutiny committees undertake a regular programme of reviews of business areas to examine issues such as the achievement of value for money and service delivery?
- Do finance/resource and other scrutiny committees regularly assess areas such as financial risks and efficiency savings?

Are reports from finance/resource and other scrutiny committees on budget plans and risks to service delivery given proper consideration by officials, with recommendations being promptly acted upon?

Do finance/resource and other scrutiny committees receive reports on the extent to which cost reductions and efficiency savings have impacted on service delivery?

There is no specific finance/resource committee. The committees that play a significant role in considering the budget plans are the senior management team and audit committee. The senior management team is involved in the setting of the budgets and this includes delivery against budgets and explanations of variances against previous years.

The senior management team and audit committee have not carried out any reviews of business areas to examine issues such as the achievement of value for money and service delivery, although management has participated in the procurement capability assessment.

On a monthly basis the senior management team assesses financial risks via the monthly budget monitoring report in discussion with budget holders.

Based on our review of minutes of the committees, reports from on budget plans and risks to service delivery are given proper consideration by officials.



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