



*cutting through complexity*

# Creative Scotland and Creative Scotland National Lottery Distribution Fund

Annual audit report to Creative Scotland and the Auditor General for Scotland

Audit: year ended 31 March 2015

29 September 2015

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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 is made available to Audit Scotland and the Auditor General for 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 circumstances set out in the executive summary: scope and responsibilities.

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 Practice 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 summarises our work in relation to the financial statements for the year ended 31 March 2015.

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

Area	Summary observations	Analysis
<b>Strategic overview</b>		
Key issues and update	<p>The governance framework and senior management individuals on the Board and team at Creative Scotland has been subject to change in 2014-15, with a new chair being appointed, in addition to new directors. A new, clearer funding approach was introduced during the year, with three clear routes to funding being regular funding, open funding and targeted funding.</p> <p>Creative Scotland has published its 2015-16 annual plan, which details the work to be delivered throughout the year and the priority areas for work, funding and the 2015-16 budget. The annual plan sits alongside the 2014-24 strategic plan: <i>Unlocking Potential, Embracing Ambition</i>. The strategic plan sets out a shared vision for the arts, screen and creative industries in Scotland, as well as Creative Scotland's ambitions for the next ten years, underpinned by the priorities for the next 12 months.</p>	Page 7
Financial position	<p>The level of Creative Scotland's grant commitments distributed through Scottish Government grant-in-aid was broadly in line with the prior year, 2014-15: £46.0 million (2013-14: £48.1 million). Grant commitments of £30.4 million distributed through the National Lottery Distribution Fund (NLDF) were significantly less than the prior year (2013-14: £41.4 million).</p> <p>Management has set a balanced budget for 2015-16 for Creative Scotland.</p> <p>The NLDF budget for 2015-16 anticipates a deficit of £5.2 million for the year, leading to net liabilities for the Distribution Fund as at 31 March 2016 of £13.1 million recognising all commitments. This reflects timing differences between ongoing National Lottery funding and the approval of commitments.</p>	Page 8
<b>Financial statements and accounting</b>		
Audit conclusions	<p>We intend to issue an unqualified audit opinion on the 2014-15 financial statements, following their approval by the Board.</p> <p>The financial statements and remuneration report were received by the start of audit fieldwork and were supported by high quality working papers. The strategic report, directors' report and governance statement were not received until 12 August 2015.</p>	Page 16

Area	Summary observations	Analysis
<b>Financial statements and accounting (continued)</b>		
<b>Significant risks and audit focus areas</b>	<p>The areas highlighted below are the specific audit focus areas identified within our audit strategy:</p> <ul style="list-style-type: none"> <li>■ accounting for grant awards;</li> <li>■ accounting for grant awards and commitments through the National Lottery Distribution Fund (NLDF); and</li> <li>■ Creative Scotland's participation in the Strathclyde Pension Fund and Arts Council Retirement Plan.</li> </ul> <p>Audit work was completed to satisfy the requirements of ISA 330 'The auditor's procedures in response to assessed risks', including tests of key financial controls. In respect of each matter, we are content with management's judgements and the accounting treatment.</p>	Pages 17-19
<b>Accounting policies</b>	<p>During the year, the Department for Culture, Media and Sport proposed changes to the Accounts Direction, with the aim of aligning the accounting policies adopted by lottery funders with the Government Financial Reporting Manual (FRoM). This change in accounting policy has been reflected by way of a prior year adjustment in the financial statements of the NLDF.</p> <p>No newly effective accounting standards are expected to have a material impact on the 2015-16 financial statements.</p>	Page 20
<b>Going concern</b>	<p><b>Creative Scotland</b></p> <p>Creative Scotland's financial statements have been prepared on a going concern basis, this is based on the agreed grant-in-aid levels approved by the Scottish Government for the organisation for 2015-16, along with the indicative settlement for 2016-17. Taken together with the budget approved for the organisation for the forthcoming financial year, this indicates that Creative Scotland will be able to operate within the funds available to it.</p> <p><b>Creative Scotland National Lottery Distribution Fund</b></p> <p>The statement of financial position for the Fund reports net liabilities of £7.9 million as at 31 March 2015. This has arisen principally because the commitments accounted for within the financial statements exceed the cash and investments held within the National Lottery Fund.</p> <p>Management's financial forecast analysis indicates its expectation that the National Lottery Distribution Fund will continue to operate in a net liabilities position until 2017-18, after which the projections show a return of the Fund to balance. This will be achieved through the Distribution Fund operating on an 'in year surplus' position going forward, achieved through a reduction in the level of grant awards specifically the ending of the capital programme. This assumes continued funding through the National Lottery at levels broadly in line with current levels. Although any changes in National Lottery participation present some risk in the later years of the projections, it is not expected to be a significant risk for the next five years.</p>	Page 21

Area	Summary observations	Analysis
<b>Governance and narrative reporting</b>		
<b>Governance</b>	<p>Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.</p> <p>During 2014-15 there have been changes in those charged with governance with a new Chair appointed in January 2015.</p>	Page 25
<b>Internal controls</b>	<p>Testing of the design and operation of financial controls over significant risk points was undertaken as part of interim and final audit testing. Our work concluded that that controls relating to financial systems and procedures are designed appropriately and operating effectively, with the exception of one material recommendation relating to authorisation and retention of journals, which was reported in our interim report with appropriate recommendations agreed with management. Management have reviewed the controls over journals and no other exceptions were found.</p> <p>Since the conclusion of our interim work there have been no changes to the operation of the other controls subject to review.</p>	Pages 25 and 26
<b>Performance management</b>		
<b>Performance management</b>	<p>Our review of Creative Scotland's performance management arrangements in the year to 31 March 2015 indicates that these continue to be appropriate. However this could be improved through more timely reporting on performance management.</p> <p>Internal audit reviews, conducted as part of the 2014-15 internal audit plan, provided assurance over Best Value considerations in the year to 31 March 2015 and did not indicate significant weaknesses.</p>	Page 29

### Purpose of this report

The Auditor General for Scotland (“the Auditor General”) has appointed KPMG LLP as auditor of Creative Scotland and Creative Scotland National Lottery Distribution Fund (“NLDF”) under the Public Finance and Accountability (Scotland) Act 2000 (‘the Act’). The period of appointment is 2011-12 to 2015-16, inclusive.

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at Creative Scotland and Creative Scotland NLDF and the Auditor General. The scope and nature of our audit were set out in the audit strategy document which was presented to the audit and risk committee at the outset of our audit.

The Code sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance.

### Accountable officer responsibilities

Audit Scotland’s *Code of Audit Practice* (the “Code”) sets out Creative Scotland’s responsibilities in respect of:

- preparation of financial statements that show a true and fair view;
- systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- financial position; and
- Best Value.

### Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code.

### Scope

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance.

Weaknesses or risks identified 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.

Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) (‘ISA’) 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

This annual audit report to members and our presentation to the audit and risk committee, together with previous reports to the committee throughout the year, discharges the requirements of ISA 260.

# Strategic overview

Our perspective on key business issues and financial position

**There were further changes to the senior management team at Creative Scotland in 2014-15.**

**An annual plan for 2015-16 has been published which sets out priorities over a twelve month period and a breakdown of the 2015-16 budget.**

**Creative Scotland simplified the way it distributes funding into three funding routes.**

Creative Scotland and the NLDF support the arts, screens and creative industries across Scotland. They distribute funding from the Scottish Government and The National Lottery. Separate annual reports and accounts are produced for Creative Scotland for the activities undertaken as a Scottish Government funding distributor and the Creative Scotland National Lottery Distribution Fund for the activities undertaken as a Lottery Distributor.

There were further changes in the governance framework and senior management team at creative Scotland in 2014-15 with a new chair appointed, in addition to new director of creative industries and a director of screen.

In April 2014 Creative Scotland published a 10 year plan from 2014-2024. This is called Unlocking Potential, Embracing Action and is a shared plan for the arts, screen and creative industries. It sets out Creative Scotland's vision, priorities, connecting themes, functions and partnerships, and how the strategy is aligned with Scottish Government National Outcomes.

Alongside the 10 year plan, Creative Scotland have also published an annual plan for 2015-16. This sets out priorities between 2014-2017, priorities over the next 12 months and links to the 10 year plan. It includes a budget for 2015-16 broken down by funding programme and organisation, and separated into grant-in-aid and lottery funding. The annual plan for 2015-16 was not published in time for the start of the new financial year and was only finalised and published in July 2015.

***Recommendation one***

From October 2014, Creative Scotland has simplified the way it distributes funding into three funding routes: regular funding for organisations for at least three years; open project funding for individuals and organisations; and targeted development funding programmes for specific purposes.

The regular funding provides more stable support for a range of funded organisations, enabling them to plan and make decisions on the basis of a three year funding agreement.

The open funding route was set up in October 2014 to support creative activity for a wide variety of projects up to a maximum of two years in length, with a defined start and end date and specific objectives.

Targeted funding has been set up to address needs specific to a sector, specialism or geographic area – including funding for film and television which was available throughout 2014-15.

In addition to simplifying the funding route process for applicants, Creative Scotland have been transitioning to a new investment management system ("CSI") which came in in 2013-14. Whilst CSI is now used for managing grant awards, historic manual processes for approvals of grant awards were maintained initially while it was ensured that CSI links effectively to the finance system.



Creative Scotland's total comprehensive expenditure for 2014-15 was £51.2 million (2013-14: £52.8 million) against Scottish Government grant-in-aid of £51.2 million (2013-14: £53.2 million).

### Financial position

Grants commitments 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 2014-15, Creative Scotland invested £46 million across over 1,000 projects and initiatives. The net operating cost for the year was £51.2 million, compared with £51.2 million drawn down in funding from the Scottish Government. Creative Scotland has decreased net expenditure funded through grant-in-aid by just over £1.5 million compared to 2013-14.

The increase in staff costs in the year arose is largely a result of a reversal, in the prior year, of the unutilised provision for additional contributions required to fund the deficit in the Arts Council Retirement Plan (1994), resulting in an increase in staff costs of £617,000. There was also an increase in the number of people employed within the Creative directorate due to additional projects in 2014-15.

Income received by Creative Scotland comprises primarily the recharge to the NLDF. The recharge is based on an estimate of time involved in delivering NLDF activities. There was an increase in the recharge of £300,000 in the year. We reviewed the basis of the percentage applied to staff costs to calculate the recharge and based on total grant expenditure across Creative Scotland (£46.03 million) and the National Lottery Distribution Fund (£30.44 million) the 40% applied appears reasonable. Other income also included rental income of £92,000 which was not received in the prior year.

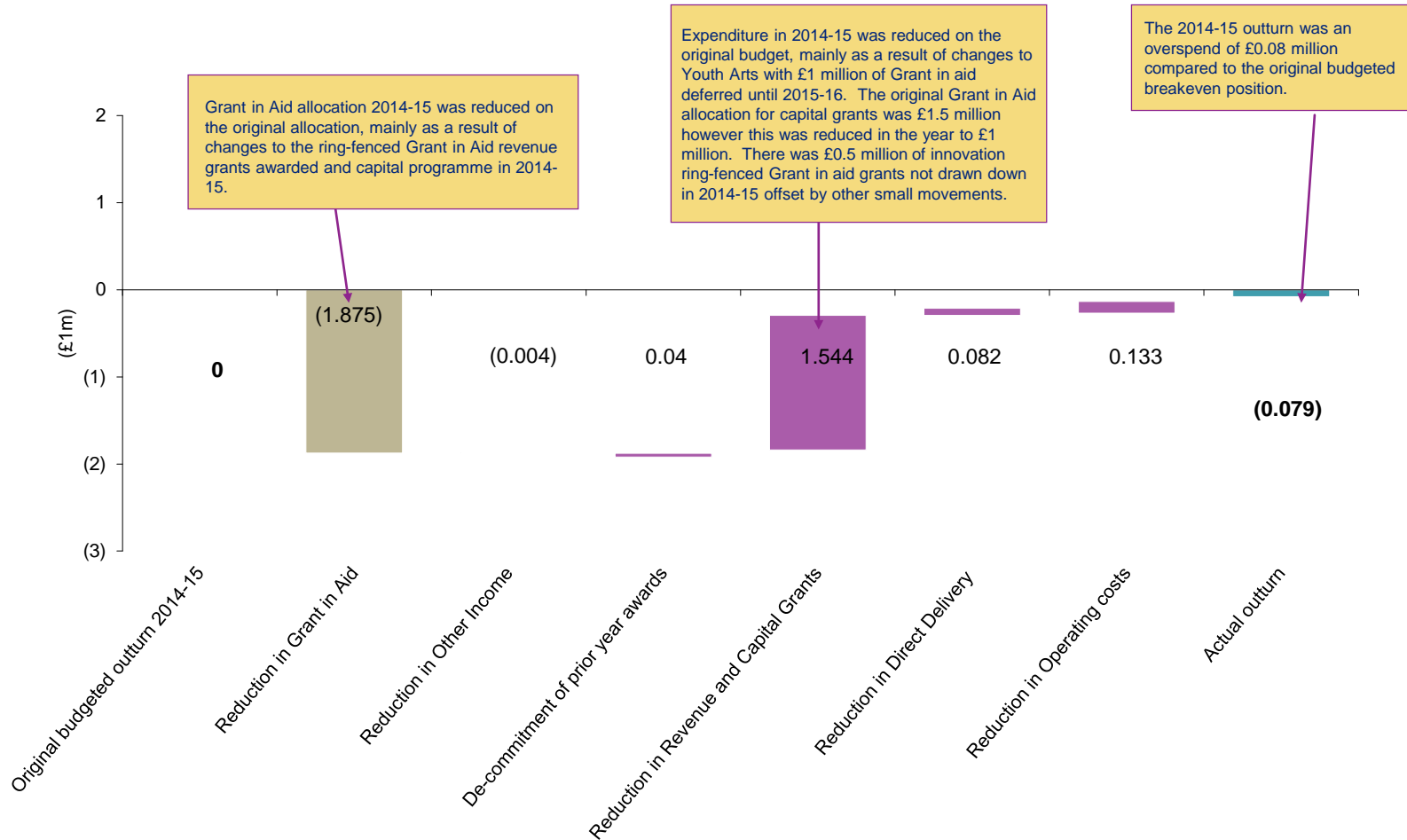
Statement of Comprehensive Net Expenditure	2014-15 £'000	2013-14 £'000	Variance £'000
Project income	105	183	(78)
Other income	2,610	2,231	379
<b>Total income</b>	<b>2,715</b>	<b>2,414</b>	<b>301</b>
Staff costs	4,668	3,703	965
Grant Commitments	46,028	48,118	(2,090)
De-commitment of awards	(141)	(268)	127
Project expenditure	629	458	171
Direct delivery expenditure	405	675	(270)
Other operating expenditure	2,095	2,259	(164)
Depreciation	246	208	38
<b>Total expenditure</b>	<b>53,930</b>	<b>(55,153)</b>	<b>1,223</b>
<b>Net operating costs</b>	<b>(51,215)</b>	<b>(52,739)</b>	<b>1,524</b>
Impairment of non-current assets	-	(21)	21
Other finance income/(costs)	(23)	(15)	(8)
<b>Net expenditure for the year</b>	<b>(51,238)</b>	<b>(52,775)</b>	<b>1,537</b>

Source: KPMG analysis of Creative Scotland's financial statements 2014-15

The next page provides an analysis of the movement in the budgeted to actual result for 2014-15.

The original 2014-15 budgeted outturn was a breakeven position. We provide an analysis of the movements from the original budget to the updated forecast undertaken by management in March 2015. The movements between this budget outturn and the actual outturn are shown opposite.

2014-15 budgeted overspend to outturn



Creative Scotland has net assets of £1.25 million as at 31 March 2015 (31 March 2014: net assets of £1.78 million).

The movement largely reflects a decrease in cash and cash equivalents of £1.68 million and a decrease in trade and other payables of £1.90 million.

**Statement of financial position**

Creative Scotland has net assets at 31 March 2015 date of £1.2 million, a movement of £0.5 million on the prior year. The key elements of the movement are set out below.

*Assets*

Cash and cash equivalents decreased by £1.7 million compared to prior year.

*Liabilities*

The decrease in total liabilities from the prior year is primarily due to a decrease in trade and other payables by £1.9 million, this was mainly as a result of a decrease in award commitments of £1.8 million. This was partly offset by the greater retirement benefit obligation.

Consideration of the pension assumptions and key movements is provided at appendix three.

Consolidated statement of financial position	2015 £'000	2014 £'000	Variance £'000
Non current assets	1,930	2,133	(203)
Trade and other receivables	458	582	(124)
Cash and cash equivalents	15,407	17,084	(1,677)
<b>Total assets</b>	<b>17,795</b>	<b>19,799</b>	<b>(2,004)</b>
Trade and other payables	(14,465)	(16,366)	1,901
Pension liabilities	(983)	(500)	(483)
Provisions	(1,102)	(1,155)	53
<b>Total liabilities</b>	<b>(16,550)</b>	<b>(18,021)</b>	<b>1,471</b>
<b>Net assets</b>	<b>1,245</b>	<b>1,778</b>	<b>(533)</b>

Source: KPMG analysis of Creative Scotland's financial statements 2014-15

The National Lottery Distribution Fund reported a significant increase in income and a decrease in expenditure in 2014-15 compared to the previous year. The former is a result of National Lottery Fund performance and Creative Scotland's share in that. Expenditure remains a reflection of the level of business activities that Creative Scotland will have, not only in the current year but in future years.

## Financial position

National Lottery Distribution Fund proceeds have increased by £5.2 million in 2014-15 due to an increase in the share of income receivable, resulting from variable purchasing habits of Lottery players and the dissolution of the Olympic Lottery Fund. This reflects the nature of the National Lottery Fund and the way in which it distributes funding depending on performance of the investment.

During 2014-15, the Department for Culture, Media and Sport issued revised accounts directions, with the aim of aligning the accounting policies adopted by lottery funders with the Government Financial Reporting Manual.

The main change arising from the changes is the removal of the requirement for NLDF to differentiate between 'hard', 'soft' and 'other' commitments which in practice excluded grants which had been approved but not yet fully contracted from recognised expenditure. Now all grant commitments are now accounted for under international accounting standards as defined by the FReM and in line with the Creative Scotland financial statements. This change has been applied by way of a prior year adjustment to the opening position for 2013-14 through the 2012-13 reserves and through the Statement of Comprehensive Income in 2013-14.

The award commitments of £30.4 million represents a significant decrease in award commitments in 2014-15, being £11 million lower than 2013-14. This decrease in award commitments was in line with the 2014-15 budget and the ending of projects for Cultural Economy (£3.3 million) and reduced commitments to National Events 2012-14 projects (£7.3 million).

Statement of Comprehensive Income	2014-15 £'000	2013-14 (restated) £'000	Variance £'000
National Lottery Fund proceeds	34,882	29,689	5,193
Other income	419	1,238	(819)
<b>Total income</b>	<b>35,301</b>	<b>30,927</b>	<b>4,374</b>
Award commitments	30,444	41,409	10,965
De-commitments	(1,313)	(460)	853
Project expenditure	260	1,130	870
Staff costs	1,788	1,661	-127
Other operating expenditure	951	848	-103
<b>Total expenditure</b>	<b>32,130</b>	<b>44,588</b>	<b>12,458</b>
<b>Total comprehensive net income</b>	<b>3,171</b>	<b>(13,661)</b>	<b>16,832</b>

Source: KPMG analysis of Creative Scotland NLDF's financial statements 2014-15

The surplus on the statement of comprehensive income has reduced the net liabilities position to £7.9 million as at 31 March 2015, compared to a net liabilities position of £11.1 million as at 31 March 2014. This reflects the fact that the forward commitments continue to exceed the investments within the National Lottery Fund available to Creative Scotland as a Lottery distributor.

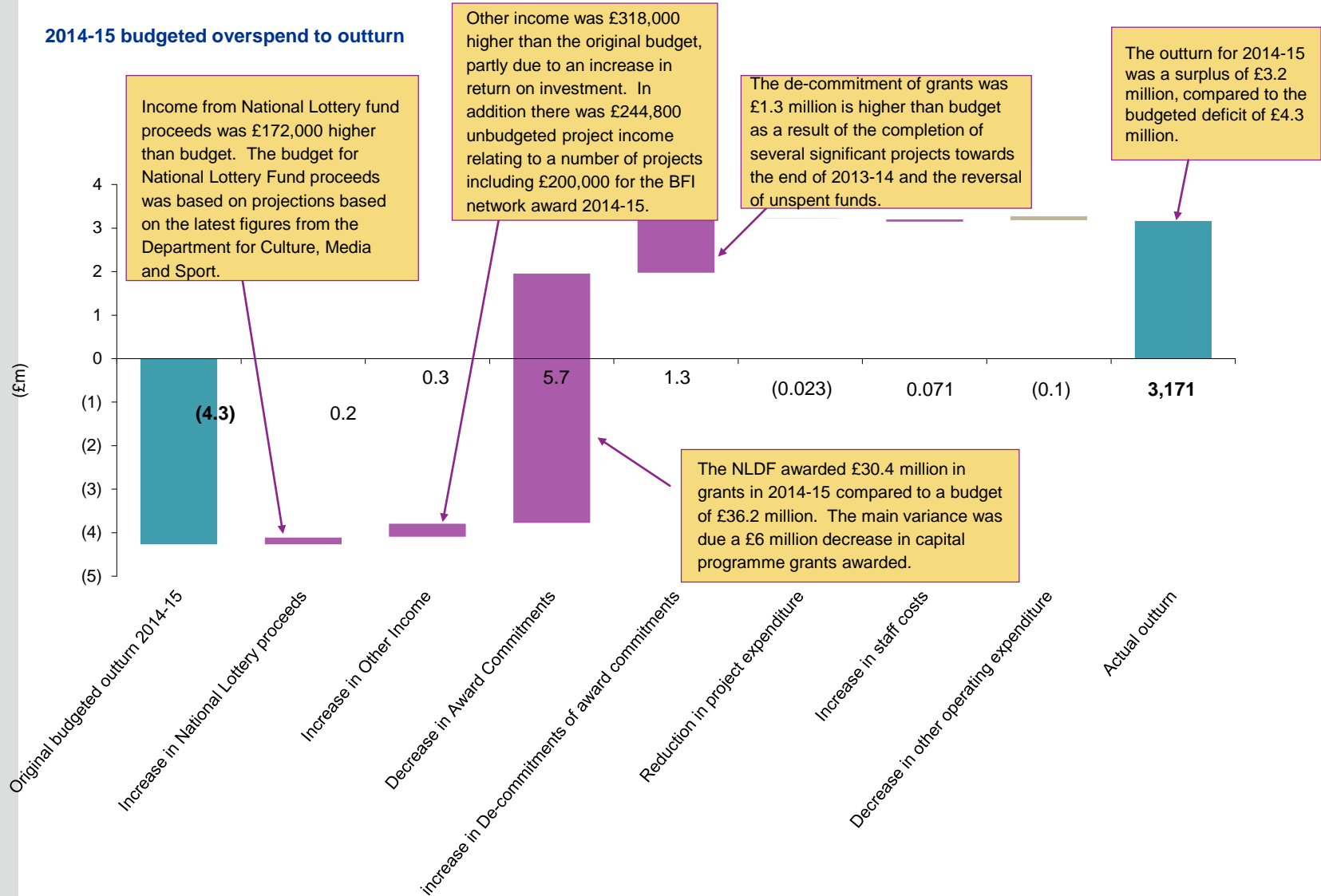
# Creative Scotland – National Lottery Distribution Fund (continued)

The NLDF has historically operated deficit budgets, as a result of timing differences between the awarding of capital grants and receiving the funding.

The outturn for 2014-15 was a surplus of £3.2 million, compared to the budgeted deficit of £4.3 million.

The movements between the budget outturn and the actual outturn are shown opposite.

## 2014-15 budgeted overspend to outturn



## Financial position – National Lottery Distribution Fund (continued)

**Creative Scotland National Lottery Distribution Fund has net liabilities of £7.9 million as at 31 March 2015 ( 31 March 2014: net liabilities of £11.1 million).**

**The movement reflects a decrease in current and non-current grant commitments of £3.1 million.**

### Statement of financial position

Creative Scotland National Lottery Distribution Fund has net liabilities at 31 March 2015 of £7.9 million, a movement of £3.2 million on the prior year. The key elements of the movement are set out below.

#### Assets

Investments in the NLDF decreased by £0.6 million which was offset by an increase in cash and cash equivalents of £0.6 million.

#### Liabilities

The decrease in net liabilities from the prior year is primarily due to a reduction in trade and other payables by £6 million, as a result of a decrease in grant commitments of £5.8 million, due to less grants being awarded in 2014-15 compared to the prior year. This was partly offset by an increase in non-current grant commitments due in more than one year of £2.8 million.

Forward commitment plans within the budgets for 2015-16 and beyond indicate that this net liabilities position will continue until 2017-18, after which the projections show a return of the NLDF to balance. We report on this under our consideration of the going concern assumptions for the National Lottery Distribution Fund financial statements.

Consolidated statement of financial position	2015 £'000	2014 (restated) £'000	Variance £'000
Trade and other receivables	216	225	(9)
Loan receivables	75	76	(1)
Investments in the NLDF	18,519	19,106	(587)
Cash and cash equivalents	724	79	645
<b>Total current assets</b>	<b>19,534</b>	<b>19,486</b>	<b>48</b>
Trade and other payables	(20,398)	(26,346)	5,948
<b>Total current liabilities</b>	<b>(20,398)</b>	<b>(26,346)</b>	<b>5,948</b>
Trade and other payables	(6,945)	(4,120)	(2,825)
provisions	(70)	(70)	-
<b>Total non-current liabilities</b>	<b>(7,015)</b>	<b>(4,190)</b>	<b>(2,825)</b>
<b>Net liabilities</b>	<b>(7,879)</b>	<b>(11,050)</b>	<b>3,171</b>

Source: KPMG analysis of Creative Scotland' NLDF's financial statements 2014-15

The budget for 2015-16 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 2015-16 – Creative Scotland

	2015-16 Budget £'000	2014-15 Budget £'000
Grants	(46,205)	(48,660)
Staff costs	(2,958)	(2,755)
Other operating costs	(1,693)	(1,876)
<b>Total expenditure</b>	<b>(50,856)</b>	<b>(53,291)</b>
<b>Income</b>	<b>50,856</b>	<b>53,292</b>
<b>Outturn planned</b>	<b>-</b>	<b>1</b>

Source: Creative Scotland 2015-16 budget

Management has set a balanced budget for 2015-16 for Creative Scotland. Expenditure on grant awards is anticipated to reduce by £2.5 million in 2015-16. This is due to the different ring-fenced grants profile from the Scottish Government and completion of Creative Scotland's capital investment programme, which was budgeted at almost £38 million and was included in the 2011-14 corporate plan.

Total staff and operating costs across Creative Scotland and NLDF are monitored as a percentage of expenditure and are projected to be £7.5 million in 2015-16, 8.5% of total expenditure, which is in line with prior year.

### Financial plans for 2015-16 – NLDF

	2015-16 Budget £'000	2014-15 Budget £'000
Grants	(34,865)	(36,193)
Staff costs	(1,907)	(1,859)
Other operating costs	(967)	(1,083)
<b>Total expenditure</b>	<b>(37,739)</b>	<b>(39,135)</b>
<b>Income</b>	<b>32,491</b>	<b>34,861</b>
<b>Outturn planned</b>	<b>(5,248)</b>	<b>(4,274)</b>

Source: Creative Scotland NLDF 2015-16 budget

The National Lottery Distribution Fund budget for 2015-16 anticipates a deficit of £5.2 million for the year, leading to net liabilities for the Distribution Fund as at 31 March 2016 of £13.1 million recognising all commitments. Lottery expenditure is budgeted to exceed income by £5.2 million due to the planned commitment to capital projects where the cash outflow will occur in future financial years.

# Financial statements and accounting policies

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



**We intend to issue an unqualified audit opinion on the financial statements and on the regularity of transactions reflected in those financial statements.**

**The majority of the financial statements, were made available on a timely basis and were accompanied by high quality working papers. The strategic report, directors' report and governance statement were not received until after the completion of our on-site fieldwork.**

### Audit conclusions

Our audit work is complete following receipt of management's representations and update of subsequent events. Following approval of the financial statements by Creative Scotland's accountable officer we intend to issue an unqualified opinion on the truth and fairness of the state of Creative Scotland's affairs as at 31 March 2015, and of its net expenditure for the year then ended. In respect of the National Lottery Distribution Fund financial statements, we intend to issued an unqualified opinion on the truth and fairness of the state of affairs as at 31 March 2015, and of its surplus for the year then ended; we also intend to issue an unqualified opinion 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 controls testing and substantive procedures to ensure that key risks to the financial statements have been covered;
- communicated with internal audit and reviewed their reports as issued to audit and risk committee to ensure all key risk areas which may be viewed to have an impact on the financial statements have been considered;
- reviewed estimates and accounting judgements made by management and considered these for appropriateness;
- considered the potential effect of fraud on the financial statements through discussions with senior management and internal audit; and
- attended audit and risk committee to communicate our findings to those charged with governance, and to update our understanding of the key governance processes.

### Financial statements preparation

- High quality working papers and draft financial statements were provided at the start of the audit fieldwork on 22 June 2015. This included the remuneration report but the strategic report, directors' report and governance statement were not received until 12 August 2015.
- 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.
- Throughout the course of the year we have had regular communication and discussion with Creative Scotland's finance team to ensure that disclosure within the financial statements was consistent with the requirements of the FReM and Accounts Direction. We provided feedback to management on the content of the financial statements, strategic report, directors' report, remuneration report and governance statement and we are pleased to report only minor adjustments were required.
- There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content, as reported in appendix one.
- We consider that management has maintained a robust control environment in the year to 31 March 2015.

The significant areas of risk identified in our audit strategy were in respect of:

- management override of controls fraud risk.

and other focus areas of:

- fraudulent revenue recognition;
- retirement benefits; and
- grant commitments.

We summarise below the risks of material misstatement as reported within the audit strategy document identified during the course of the audit. We set out the key audit procedures to address those risks and our findings from those procedures, in order that the audit and risk committee may understand the process by which we arrived at our audit opinion.

We have no changes to the risk or our approach to addressing the assumed ISA risks of fraud in management override of controls. We do not have findings to bring to your attention in relation to this matter; no control overrides were identified.

Audit focus areas	Our response	Audit findings
<p><b>Retirement benefits – Strathclyde Pension Fund</b></p> <p>Creative Scotland accounts for its participation in the Strathclyde Pension Fund in accordance with IAS 19 <i>Retirement benefits</i>, using a valuation report prepared by actuarial consultants. Creative Scotland's actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases.</p> <p>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. The determination of the retirement benefit obligation is inherently judgemental and there is a financial statement risk as a result.</p>	<p>Our audit work consisted of:</p> <ul style="list-style-type: none"> <li>KPMG specialists reviewing the financial assumptions underlying actuarial calculations and comparison to our central benchmarks, the result of which are on page 35;</li> <li>testing the scheme assets and rolled-forward liabilities;</li> <li>testing the level of contributions used by the actuary to those actually paid during the year;</li> <li>testing the membership data used by the actuary to data from Creative Scotland; and</li> <li>agreeing actuarial reports to financial statement disclosures.</li> </ul>	<p>We are satisfied that the retirement benefit obligation:</p> <ul style="list-style-type: none"> <li>is correctly stated in the balance sheet as at 31 March 2015;</li> <li>has been accounted for and disclosed correctly in line with IAS19 <i>Retirement benefits</i>; and</li> <li>assumptions used in calculating this estimate and managements judgements are appropriate and within the acceptable KPMG range.</li> </ul> <p>We set out further information in respect of the defined benefit obligation in appendix three. The defined benefit obligation increased by £483,000 compared to 31 March 2014, driven by a reduced discount rate and increased mortality assumption.</p>

Audit focus areas	Our response	Audit findings
<p><b>Retirement benefits – Arts Council Retirement Plan (1994)</b></p> <p>Creative Scotland participates in the Arts Council Retirement Plan (1994) which is a defined benefit pension scheme. This has historically been accounted for as a defined contribution pension scheme on the basis that Creative Scotland has been unable to identify its share of the relevant assets and liabilities.</p>	<p>We reviewed information received by management from Hymans Robertson LLP, the actuaries to the Plan, with regard to the balance sheet item as at 31 March 2015 in respect of Creative Scotland's obligations to pay deficit contributions to the Plan.</p> <p>We enquired with management and considered the appropriateness of continuing to account for the plan as a defined contribution plan.</p>	<p>Management have made the appropriate disclosures within the financial statements as if the Plan were accounted for on a defined contribution basis, the unfunded pension provision has been appropriately updated and we are in agreement with this treatment.</p> <p>The requirement to change accounting to reflect Creative Scotland's share of liabilities will be considered in future years.</p>
<p><b>Accounting for grant awards – (grant-in-aid)</b></p> <p>The majority of Creative Scotland's expenditure relates to grant awards. Appropriate recognition of this expenditure at 31 March 2015 will be required to ensure accurate financial performance is reported in the financial statements.</p> <p>From October 2014, Creative Scotland and the Lottery Fund have a new simplified funding stream process. This is in addition to the transition to the new CSI system for recording assessment and approval of grants.</p>	<p>Cut-off testing was performed, agreeing balances to third party evidence to verify that expenditure is recorded in the correct financial year.</p> <p>A sample of grant expenditure was agreed to signed grant award to verify the amounts presented as expenditure and income related to the 2014-15 financial year. A sample of accruals were vouched to grant awards to verify they related to the 2014-15 financial year.</p>	<p>No exceptions were noted from the testing performed.</p> <p>In respect of the expenditure relating to grants, awards and investments, we are satisfied that expenditure reported in the financial statements for the year to 31 March 2015 relates to the 2014-15 financial year and has been appropriately recognised.</p> <p>We will review the new CSI system as part of our 2015-16 audit.</p>

Audit focus areas	Our response	Audit findings
<p><b>Accounting for grant awards and commitments – NLDF</b></p> <p>The majority of the Lottery Fund's expenditure also relates to grant awards. Appropriate recognition of this expenditure and related commitments at 31 March 2015 will be required to ensure accurate financial performance is reported in the financial statements.</p> <p>In previous years, accurate disclosure in the Lottery Fund's financial statements has been reliant on the accurate identification of hard, soft and other commitments, as required by the Accounts Direction by the Scottish Ministers in respect of its National Lottery distribution activities.</p> <p>The last Accounts Direction was published in January 2012. The Department for Culture, Media and Sport drafted a revised Accounts Direction for year ending 31 March 2015. This removes the requirement to differentiate between hard and soft commitments. This will affect how commitments are accounted for and disclosed in the financial statements.</p>	<p>Creative Scotland were required to adopt the revised Accounts Direction for the year ended 31 March 2015 which removed the requirement to differentiate between 'hard', 'soft' and 'other' commitments and instead all grant commitments are accounted for under international accounting standards as defined by the FReM.</p> <p>The restatement of lottery grant commitments was reviewed to ensure the appropriate adjustments had been made and were in line with the revised Accounts Direction and the FReM. The disclosure of the restatement within the financial statements was reviewed for completeness and appropriateness.</p> <p>Cut-off testing was performed, agreeing balances to third party evidence to verify that expenditure is recorded in the correct financial year.</p> <p>Grant expenditure was agreed to signed grant award to verify the amounts presented as expenditure and income related to the 2014-15 financial year. A sample of accruals were vouched to grant awards to verify they related to the 2014-15 financial year.</p>	<p>Creative Scotland have updated the accounting policy for lottery grant commitments, all grant expenditure is now recognised when the grants are approved and a contract has been issued to the applicant. The opening position for 2012-13 has been appropriately adjusted through reserves. The 2013-14 balance sheet and Statement of Comprehensive Income have been appropriately restated to reflect the change in accounting policy.</p> <p>No exceptions were noted from the testing performed.</p> <p>In respect of the expenditure relating to grant awards, we are satisfied that expenditure reported in the financial statements for the year to 31 March 2015 relates to the 2014-15 financial year and has been appropriately recognised.</p> <p>We will review the new CSI system as part of our 2015-16 audit.</p>

There has been one change to adopted accounting policies in the year in the Creative Scotland NLDF financial statements relating to grant commitments.

Accounting framework and application of accounting policies		
Area	Our response	Audit findings
<b>Accounting policies</b>	<ul style="list-style-type: none"> <li>There has been one change to adopted accounting policies in the year in the Creative Scotland NLDF financial statements. This change related to the accounting for grant commitments, and was agreed and adopted by permission of the Scottish Ministers, by way of amendment to the schedule of additional accounting and disclosure requirements.</li> <li>Critical accounting judgements continue to relate to the present value of defined benefit obligations under IAS 19 (as calculated by Creative Scotland's actuary, Hymans Robertson) using agreed financial assumptions. We considered the appropriateness of these assumptions and the accounting for pensions on page 35 and 36.</li> <li>We are satisfied that the accounting policies adopted remain appropriate.</li> </ul>	We are satisfied that accounting policies and critical estimates adopted in the preparation of the financial statements remain appropriate. We have not identified indications of management bias.
<b>Financial reporting framework</b>	<ul style="list-style-type: none"> <li>Creative Scotland prepares financial statements in accordance with HM Treasury's Financial Reporting Manual 2014-15 ("FRoM").</li> <li>There have been no relevant changes to the financial reporting framework in the year, other than minor changes to the disclosure of compensation payments within the remuneration report, however these have had no impact for Creative Scotland or Creative Scotland NLDF.</li> <li>Creative Scotland National Lottery Distribution Fund prepares financial statements in accordance with the Accounts Direction issued by the Scottish Government and the HM Treasury's Financial Reporting Manual 2014-15 ("FRoM").</li> </ul>	We are satisfied that the financial reporting framework has been correctly applied.

The financial statements have been appropriately prepared on a going concern basis, having due consideration of the agreement of grant-in-aid in respect of 2015-16.

Accounting framework and application of accounting policies		
Area	Our response	Audit findings
<b>Going concern</b>	<p><b>Creative Scotland</b></p> <ul style="list-style-type: none"> <li>■ Creative Scotland's financial statements have been prepared under the assumption that the organisation is a going concern. This is based on the agreed grant-in-aid levels approved by the Scottish Government for the organisation for 2014-15, along with the indicative settlement for 2015-16. Taken together with the budget approved for the organisation for the forthcoming financial year, this indicates that Creative Scotland will be able to operate within the funds available to it.</li> </ul> <p><b>Creative Scotland National Lottery Distribution Fund</b></p> <ul style="list-style-type: none"> <li>■ The statement of financial position for the Fund reports net liabilities of £11.05 million as at 31 March 2015. This has arisen principally because the commitments accounted for within the financial statements continue to exceed the cash and investments held within the National Lottery Fund. The Accounts Direction given by the Scottish Ministers advises that where <i>"the commitments exceed available resources shown on the Balance Sheet, there should be a note explaining the rationale for the over-commitment in terms of the benchmark being applied and the assumptions behind it, taking into account any advice received from the Scottish Ministers as appropriate."</i></li> <li>■ Management's financial forecast analysis indicates its expectation that the National Lottery Distribution Fund will continue to operate in a net liabilities position until 2018-19, after which the projections show a return of the Fund to balance. This will be achieved through the Distribution Fund operating on an in year surplus position from 2016-17 onwards, achieved through a level of grant awards significantly below that budgeted for 2015-16. This assumes continued funding through the National Lottery at levels broadly in line with current levels, although any changes in National Lottery participation presents some risk in the later years of the projections.</li> </ul>	<p>We concur with management's view that the going concern assumption remains appropriate for the reasons noted.</p> <p>We are satisfied that the going concern disclosure remains appropriate. This incorporates the support from Scottish Government and the fact that the pension deficit does not become due in the next 12 months, although contributions will be increased to improve funding position.</p>

**Our testing of the annual report and remuneration report confirms that these are consistent with the financial statements and with required disclosures per the FReM.**

Area	Our response	Audit findings
<b>Annual report, including the strategic and directors' reports</b>	<p>The financial statements form part of the annual report of Creative Scotland for the year ended 31 March 2015. We reviewed the contents of the strategic and directors' report against the disclosure requirements and are content with the proposed reports. We provided management with only minor suggestions relating to how the reports could be enhanced.</p>	<p>We are required to consider the strategic and directors' reports, and provide our opinion on the consistency with the financial statements. We are satisfied that the information contained within the strategic and directors' report is consistent with the financial statements.</p>
<b>Remuneration report</b>	<p>The remuneration report was provided during the onsite audit and was supported by good quality information and working papers. During the audit we agreed that additional disclosures were required to ensure the presentation of the remuneration report was in line with the FReM.</p> <p>The changes required to the remuneration report included:</p> <ul style="list-style-type: none"> <li>■ The inclusion of pension benefit information in table one;</li> <li>■ Recalculation of the median and ratio.</li> </ul> <p>We discussed the presentation of the above matters with management, and confirmed that the remuneration report was updated in accordance with the requirements of the FReM.</p>	<p>We are satisfied that the information contained within the remuneration report is consistent with the underlying records, the financial statements and the structure of the executive leadership group.</p>

Our testing of the annual report and remuneration report confirms that these are consistent with the financial statements and with required disclosures per the FReM.

Area	Our response	Audit findings
<p><b>Related parties</b></p>	<p>Creative Scotland has a number of related parties. The Creative Scotland National Lottery Distribution Fund has a number of transactions with Creative Scotland through recharges and there are further transactions with the Scottish Government.</p>	<p>We are satisfied that the information contained within the related party note is consistent with the underlying records. We were unable to review the register of interests for 2014-15 as these had not been completed by all the Board members and the information available on the website was for 2012-13.</p> <p>It is recommended that the Board members update the register of interest forms as requested by management to allow current information to be available on the Creative Scotland website.</p> <p style="text-align: right;"><i>Recommendation two</i></p>



# Governance and narrative reporting

Our overall perspective on the narrative reporting, including the annual governance statement

Update on controls findings from our audit

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

Our testing of the design and operation of financial controls over significant risk points undertaken as part of our interim work identified no issues.

Area	Our response	Audit findings
<b>Annual governance statement and governance arrangements</b>	<p>The statement for 2014-15 outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on Creative Scotland's and Creative Scotland NLDF's governance framework, operated internal controls, the work of internal audit, and risk management arrangements and analyses the efficiency and effectiveness of these elements of the framework.</p> <p>Creative Scotland is overseen by a Board of directors and its work is supported by four committees which meet regularly: audit and risk; finance and general purposes; and Chairs' committee. Reports from each are presented to the Board for consideration.</p> <p>The governance framework and senior management team at Creative Scotland has been subject to change in 2014-15, with a new chair being appointed, in addition to new directors.</p> <p>Creative Scotland and the NLDF operate a risk management team which is compliant with guidance issued by Scottish Ministers. Risk registers are operated for the organisation as a whole and are also regularly reviewed. Actions within registers are assigned owners to ensure the accountability of actions to reduce and mitigate risk.</p> <p>Creative Scotland's and NLDF's system of internal control is designed to manage risk and is based on a framework of financial regulations, accountability and regular review of financial management information. Internal controls are reviewed annually by management to ensure effective operation of controls over financial, operational and risk management processes. Internal audit provides assurance over the effective management of the internal control framework. Internal audit completed eight reviews in the year to 31 March 2015, none of which identified significant weaknesses in controls.</p>	<p>We have updated our understanding of the governance framework and documented this through our overall assessment of Creative Scotland's risk and control environment. We consider the governance framework and annual governance statement to be appropriate for Creative Scotland and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.</p>
<b>Internal controls</b>	<p>Management is responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the financial statements. 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 designed appropriately and operating effectively.</p>	<p>Our work concluded that that controls relating to financial systems and procedures are designed appropriately and operating effectively.</p>

We raised one moderate-level recommendation in the interim audit report, in respect of journal authorisation and retention of supporting documentation.

Area	Our response	Audit findings
<p><b>Internal controls</b> (continued)</p>	<p>The findings of our controls testing relate only to those matters identified during our normal audit work, in accordance with the Code, and there may still be weaknesses or risks within the control environment which have not been identified through this work. KPMG's identification of weaknesses, where applicable, does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.</p> <p>As part of our interim audit report, we raised a moderate-level recommendation in respect of internal controls. This related to:</p> <ul style="list-style-type: none"> <li>■ Authorisation of journals and retention of supporting documentation.</li> </ul> <p>The recommendation in respect of journal entries was due to be implemented immediately, following the issue of our audit strategy and interim report. We tested an initial sample of 25 journal entries and found that one had not been authorised. As a result of the control weakness identified we extended our sample of journals tested during our year end audit to test journals through the year and did not identify any issue.</p>	<p>The recommendation relating to journals was implemented immediately and we did not identify any issues with the journals tested during our year end audit.</p> <p>Since the conclusion of our interim work there have been no changes to the operation of the other controls subject to review.</p>
<p><b>Prevention and detection of fraud</b></p>	<p>No material fraud or other irregularities were identified during the year and we consider that Creative Scotland has appropriate arrangements to prevent and detect fraud both within itself and, through the work of the compliance team, within training providers on a reasonable assurance basis.</p> <p>The arrangements include policies and codes of conduct for staff and Board members of Creative Scotland.</p>	<p>We consider that Creative Scotland has appropriate arrangements to prevent and detect fraud.</p>
<p><b>Maintaining standards of conduct and the prevention and detection of corruption</b></p>	<p>Creative Scotland has arrangements including policies and codes of conduct for staff and Board members, supported by a whistleblowing policy. Board members are responsible for setting the 'tone at the top' and are responsible for abiding by the code of conduct and disclosing interests which may be of importance, material or otherwise, to their work at Creative Scotland.</p>	<p>We consider that Creative Scotland has appropriate arrangements to prevent and detect inappropriate conduct and corruption.</p>

Area	Our response	Audit findings
<p><b>Internal audit</b></p>	<p>The internal auditor of Creative Scotland and the NLDF is Scott Moncrieff. An annual audit plan was approved by the audit and risk committee and progress against the plan reported throughout the year. Internal audit takes a risk based approach to its work and supports management in maintaining sound corporate governance and internal controls through the independent examination and evaluation of control systems and the reporting of any weaknesses to management for action.</p> <p>Audit Scotland's Code of Audit Practice sets out the wider dimension of public sector audit. It requires external auditors to perform an annual assessment of the adequacy of the internal audit function. We considered the activities of internal audit against the requirements of Public Sector Internal Audit Standards ('PSIAS'), focusing our review on the public sector requirements of the attribute and performance standards contained within PSIAS. This included a review of the internal audit charter, reporting lines, independence, objectivity and proficiency and the range of work carried out by internal audit.</p> <p>From this assessment, and considering the requirements of International Standard on Auditing 610 (<i>Considering the Work of Internal Audit</i>), we can apply the internal auditor's work to inform our procedures, where relevant. The review of internal audit reports and conclusions did not indicate additional risks and there is no impact on our planned substantive testing.</p> <p>Internal audit have completed their agreed plan for the year ended 31 March 2015, and the annual report states that <i>"Creative Scotland has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of corporate objectives and the management of key risks."</i></p>	<p>We have concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards.</p> <p>The Internal Auditor has completed all scheduled main and follow up reviews as per the annual audit plan.</p> <p>The annual audit report provides "reasonable assurance".</p>
<p><b>National Fraud Initiative NFI")</b></p>	<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. Our review of Creative Scotland's NFI participation resulted in an amber grading (mostly adequate with minor areas for improvement) and our findings have been separately reported to Audit Scotland, in accordance with issued guidance.</p> <p>We note that since our initial review management have documented information and closed out all the recommended matches on the NFI website in time for our final review.</p>	<p>We consider that Creative Scotland has participated in the NFI process, and the finance manager had carried out an informal review of the matches, the matches had not been closed out on the NFI website on our first review but had been closed out in time for our final review.</p>

# Performance management

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

Our work has identified that Creative Scotland's Best Value and performance management arrangements are generally robust.

Area	Our response	Audit findings
<p><b>Performance management and Best Value</b></p>	<p>Scottish Government guidance for Accountable Officers on Best Value in public services requires a systematic approach to self-evaluation and continuous improvement. The guidance identifies the themes an organisation needs to focus on in order to deliver the duty of Best Value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.</p> <p>The annual plan 2014-15 sets out the intentions for Creative Scotland to use 2014-15 to collect baseline performance management data and to continue to research and build performance measures. The annual plan included measures by which the organisation will monitor and report its performance during 2014-15, in order to focus on continual improvement and allow for open transparent reporting. The alignment of Creative Scotland's strategic goals to the Scottish Government's national performance outcomes is to be reported within a annual performance report, alongside the measured results on the achievement of own objectives.</p> <p>Creative Scotland have committed to publishing the Annual Review of Performance for 2014-15 in December of this year, to allow reporting on returns from regularly funded organisations, the publication of national statistics in September and the reconciliation of funding data.</p> <p>To consider the controls and processes to support Best Value aims, internal audit has performed reviews in the year to 31 March 2015 over:</p> <ul style="list-style-type: none"> <li>■ Funding administration process;</li> <li>■ Investment strategy development; and</li> <li>■ Workforce management.</li> </ul> <p>Our consideration of the work of internal audit, as part of our extended control work, did not indicate high risk findings within these areas.</p> <p>The strategic internal audit plan for 2015 -16 aims to provide assurance of Best Value through reviews covering corporate governance and change management. These reviews will be linked to the Audit Scotland Best Value toolkits, where appropriate.</p>	<p>We consider that Creative Scotland has appropriate arrangements to effectively manage performance and achieve Best Value in processes.</p> <p>This could be improved through the more timely reporting on performance management throughout the year and publication of the annual review of performance earlier than nine months after year-end.</p> <p style="text-align: right;"><b><i>Recommendation three</i></b></p>

Area	Our response	Audit findings
<p><b>Local response to national studies</b></p>	<p>Audit Scotland periodically undertakes national studies on topics relevant to the performance of central government bodies. To ensure that added value is secured through the role of Audit Scotland and its appointed auditors, auditors will continue to ensure that audited bodies respond appropriately to reports from Audit Scotland's programme of national performance audits.</p> <p>Creative Scotland's finance team reviews Audit Scotland report outputs on a regular basis and seek assurance from service directors that plans are in place to address recommendations, as appropriate. Relevant reports are provided at audit and risk committee throughout the year; this ensures that sector and national issues are identified and that there is appropriate challenge for management in addressing any potential weaknesses in Creative Scotland's processes.</p>	<p>We consider that Creative Scotland has appropriate arrangements to effectively respond to national studies.</p>
<p><b>Financial capacity in public bodies</b></p>	<p>Through the process of feedback through annual audit reports, current issues reports and sector meetings, Audit Scotland identified that overall reductions in staff numbers in public bodies may be affecting the capacity of back-office functions and specifically finance.</p> <p>Audit Scotland requested the collation of baseline data across the public sector to inform sector specific overview reports and may inform a follow-up to the joint report on the public sector workforce which was published in November 2013 or support the development of the future performance audit programme.</p> <p>We have completed a return to Audit Scotland in respect of our findings. Our review in response to the request for data collection identified that there is appropriate financial capacity within the organisation to ensure effective management, however performance of strategic level financial planning could be increased.</p>	<p>We consider that Creative Scotland has appropriate financial capacity to effectively manage the organisation.</p> <p>The three year plan could be improved through more detail of the assumptions used to produce the budget and further sensitivity analysis.</p> <p>Financial management could be further improved through the timely reporting of longer-term strategic level financial plans.</p>

# Appendices



**There were no changes to the core financial statements and there are no unadjusted audit differences**

Area	Key content	Reference
<b>Adjusted audit differences</b> Adjustments made as a result of our audit	There were no audit adjustments required to the draft financial statements which impacted on the net assets or net operating cost for the year.	-
<b>Unadjusted audit differences</b> Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you.  There are no unadjusted audit differences.	-
<b>Confirmation of Independence</b> Letter issued to the Audit and Risk Committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Partner and audit staff.	Appendix two
<b>Schedule of Fees</b> Fees charged by KPMG for non-audit services	We have concluded that non-audit fees of £1,500 for the year in respect Media Antenna grant audit do not compromise our independence.	Appendix two
<b>Draft management representation letter</b> Proposed draft of letter to be issued by Creative Scotland to KPMG	There are no changes to the standard representations required for our audit from last year.	-

Area	Key content	Reference
<p>Materiality – Creative Scotland</p> <p>The materiality applied to audit testing.</p>	<p>We assessed materiality based on our knowledge and understanding of Creative Scotland's risk profile and financial statements balances. Materiality was determined at £1.05 million; approximately 2% of total expenditure, and is broadly consistent with the materiality identified in our audit strategy.</p> <p>We designed our audit procedures to detect errors at a lower level of precision, i.e. £790,000.</p> <p>We report identified errors greater than £55,000 to the audit and risk committee.</p>	
<p>Materiality – Creative Scotland NLDF</p> <p>The materiality applied to audit testing.</p>	<p>We assessed materiality based on our knowledge and understanding of Creative Scotland NLDF's risk profile and financial statements balances. Materiality was determined at £645,000; approximately 2% of total expenditure, and is broadly consistent with the materiality identified in our audit strategy.</p> <p>We designed our audit procedures to detect errors at a lower level of precision, i.e. £485,000.</p> <p>We report identified errors greater than £32,000 to the audit and risk committee.</p>	

**Auditing standards require us to consider and confirm formally our independence and related matters in our dealings with Creative Scotland.**

**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 Creative Scotland 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 Partners 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 board of directors.

### **Confirmation of audit independence**

We confirm that as of 29 September 2015, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Partner and audit staff is not impaired.

This letter is intended solely for the information of the audit committee and should not be used for any other purpose.

Yours faithfully  
KPMG LLP

In respect of employee benefits, each of the assumptions used to value Creative Scotland's net pension deficit are within an acceptable range of KPMG's expectations.

We set out below the assumptions in respect of employee benefits.

Defined benefit pension liability																													
2015 £'000	2014 £'000	KPMG comment																											
(983)	(500)	<p>In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19 pension scheme valuation.</p> <p>Details of key actuarial assumptions are included in the table, along with our commentary.</p> <table border="1"> <thead> <tr> <th>Assumption</th> <th>Creative Scotland 2013-14</th> <th>Creative Scotland 2014-15</th> <th>KPMG central</th> <th>Comment</th> </tr> </thead> <tbody> <tr> <td>Discount rate (duration dependent)</td> <td>4.30%</td> <td>3.20%</td> <td>3.21% - 3.36%</td> <td>Acceptable. The corporate bond yield curve used to calculate the discount rate has been updated from the prior year.</td> </tr> <tr> <td>CPI inflation</td> <td>RPI - 0.8%</td> <td>RPI - 0.9%</td> <td>RPI - 1.0%</td> <td>We consider that the CPI inflation used in calculating the liability is prudent, resulting in a higher liability. Taken into consideration with the net discount rate (below), however, we are comfortable that the assumption is within the acceptable range.</td> </tr> <tr> <td>Net discount rate (discount rate - CPI)</td> <td>1.40 - 1.50%</td> <td>0.80%</td> <td>1.02% - 1.05%</td> <td>Acceptable. Creative Scotland's assumption falls within the acceptable range of +/- 0.3%.</td> </tr> <tr> <td>Salary growth</td> <td>1% pa until 31 March 2015; 1.5% above RPI</td> <td>1% pa until 31 March 2016; 1.0% above RPI</td> <td>Typically 1.0 - 1.5% above RPI</td> <td>Acceptable. The assumption is acceptable under IAS19.</td> </tr> </tbody> </table>			Assumption	Creative Scotland 2013-14	Creative Scotland 2014-15	KPMG central	Comment	Discount rate (duration dependent)	4.30%	3.20%	3.21% - 3.36%	Acceptable. The corporate bond yield curve used to calculate the discount rate has been updated from the prior year.	CPI inflation	RPI - 0.8%	RPI - 0.9%	RPI - 1.0%	We consider that the CPI inflation used in calculating the liability is prudent, resulting in a higher liability. Taken into consideration with the net discount rate (below), however, we are comfortable that the assumption is within the acceptable range.	Net discount rate (discount rate - CPI)	1.40 - 1.50%	0.80%	1.02% - 1.05%	Acceptable. Creative Scotland's assumption falls within the acceptable range of +/- 0.3%.	Salary growth	1% pa until 31 March 2015; 1.5% above RPI	1% pa until 31 March 2016; 1.0% above RPI	Typically 1.0 - 1.5% above RPI	Acceptable. The assumption is acceptable under IAS19.
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Discount rate (duration dependent)	4.30%	3.20%	3.21% - 3.36%	Acceptable. The corporate bond yield curve used to calculate the discount rate has been updated from the prior year.																									
CPI inflation	RPI - 0.8%	RPI - 0.9%	RPI - 1.0%	We consider that the CPI inflation used in calculating the liability is prudent, resulting in a higher liability. Taken into consideration with the net discount rate (below), however, we are comfortable that the assumption is within the acceptable range.																									
Net discount rate (discount rate - CPI)	1.40 - 1.50%	0.80%	1.02% - 1.05%	Acceptable. Creative Scotland's assumption falls within the acceptable range of +/- 0.3%.																									
Salary growth	1% pa until 31 March 2015; 1.5% above RPI	1% pa until 31 March 2016; 1.0% above RPI	Typically 1.0 - 1.5% above RPI	Acceptable. The assumption is acceptable under IAS19.																									
<p>The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of between 17 and 23 years. The closing deficit increased by £0.48 million compared to 2013-14, primarily due to changes in financial assumptions, driven by the decrease in discount rate and changes to demographic assumptions, the latter having been driven by the latest triennial valuation as at 31 March 2014. Creative Scotland's assumptions are towards the prudent end of KPMG's acceptable range.</p>																													

The table opposite shows the reconciliation of the movement in the statement of financial position.

Increases to the pension scheme deficit in the year have been driven by changes to financial assumptions, primarily as a result of a decrease to the discount rate and demographic assumptions.

Our pension specialists have confirmed that the movements within I&E and OCI are reasonable for the size and duration of Creative Scotland's pension scheme.

	£'000	Deficit / loss	Surplus / gain	Impact	Commentary
	Opening pension scheme deficit			(500)	The opening IAS19 deficit at 31 March 2014 for the Scheme was £0.5 million (consisting of assets of £5.6 million and defined benefit obligation of £6.1 million).
I & E	Service cost			(152)	The Scheme remains open to accrual. The employer's share of the cost of benefits accruing over the year is £152,000.
	Net interest			(23)	This is the interest on the opening deficit of £0.5 million, adjusted for contributions paid during the period.
Cash	Contributions			116	The Company made cash contributions over the year of £116,000, which is broadly in line with contributions made last year, allowing for assumed salary increases.
OCI	Actuarial loss – demographic assumptions			(164)	There was an actuarial loss on the demographic assumptions of around £162,000 as a result of the mortality rates increasing by 1.1 to 22.1 for males and 0.2 to 23.6 for females.
	Actuarial loss – financial assumptions			(880)	There was an actuarial loss on the financial assumptions of around £0.88 million. This is primarily due to a 1.1% decrease in the discount rate assumption as a result of falls in corporate bond yields.  This is broadly what we would expect for a scheme with liabilities of £6 million.
	Return on assets			402	The return on Plan assets, excluding interest on assets of £23,000, was £0.4 million.
	Actuarial gain – other experience adjustments			217	There was an actuarial gain of £217,000, as a result of better than expected experience between the 2011 and 2014 triennial valuations in respect of mortality, salary growth, and member movements.
	Closing pension scheme deficit			(983)	The closing IAS19 deficit for the Scheme at 31 March 2015 is £1 million (consisting of assets of £6.2 million and defined benefit obligation of 7.2 million).

I&E – impacts on surplus/(deficit) within statement of comprehensive net expenditure

Cash – cash-flow impact

OCI – charged through other comprehensive income

The action plan summarises specific recommendations arising from our work, together with related risks and management’s responses.

Priority rating for recommendations		
<p><b>Grade one</b> (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.</p>	<p><b>Grade two</b> (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.</p>	<p><b>Grade three</b> (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.</p>
Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<p><b>1 Publication of budget and annual plan (page 7)</b></p> <p>Alongside the 10 year plan, Creative Scotland have also published an annual plan for 2015-16. This sets out priorities over the next 12 months and links to the 10 year plan. It includes a budget for 2015-16 broken down by funding programme and organisation, and separated into grant-in-aid and lottery funding. The annual plan for 2015-16, was not published in time for the start of the new financial year and was only finalised and published by the end of July 2015, four months after the start of the 2015-16 financial year.</p>	<p>It is recommended that management prepare and publish the annual plan for the start of the financial year, to ensure it is timely and relevant.</p>	<p style="text-align: center;">Grade three</p> <p><b>Responsible officer:</b> Director of Finance</p> <p><b>Implementation date:</b> April 2016</p> <p>The budget for the year is approved and published internally in advance of the financial year commencing. The annual plan timetable is being reviewed with the aim of ensuring publication at the beginning of the year, although finalisation does depend on a number of external factors such as agreeing the letter of guidance from the Cabinet Secretary.</p>

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<p><b>2 Updating register of interest (page 23)</b></p> <p>Creative Scotland has a number of related parties. The Creative Scotland National Lottery Distribution Fund has a number of transactions with Creative Scotland through recharges and there are further transactions with the Scottish Government.</p> <p>We were unable to review the register of interests for 2014-15 as these had not been completed by all the Board members and the information available on the website was for 2012-13.</p>	<p>It is recommended that the Board members update the register of interest forms as requested by management to allow current information to be available on the Creative Scotland website</p>	<p style="text-align: center;">Grade three</p> <p><b>Responsible officer:</b> Director of Finance</p> <p><b>Implementation date:</b> September 2015</p> <p>Board members will be reminded of their obligations to submit the register of interests form on an annual basis. The updated register will then be published on our website.</p>
<p><b>3 Performance Management (page 29)</b></p> <p>Creative Scotland have committed to publishing the Annual Review of Performance for 2014-15 in December of this year, to allow reporting on returns from regularly funded organisations, the publication of national statistics in September and the reconciliation of funding data.</p> <p>We consider that Creative Scotland has appropriate arrangements to effectively manage performance and achieve Best Value in processes.</p> <p>The publication of the Annual Review of Performance for 2014-15 will be nine months after year end. Performance management could be improved through the more timely publication of the annual review.</p>	<p>It is recommended that Creative Scotland improve their performance management reporting to provide timely review against Key Performance Indicators and report performance to the Board throughout the year and not just at year end.</p>	<p style="text-align: center;">Grade three</p> <p><b>Responsible officer:</b> Director of Finance</p> <p><b>Implementation date:</b> December 2015</p> <p>We will continue to review the performance management framework and timetable for publication of KPI's and performance data to the Board.</p>



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