Scottish Screen National Lottery Distribution Fund

Report on the 2005/06 Audit

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Executive Summary

Introduction

In 2005/06 we audited the financial statements of the Scottish Screen National Lottery Distribution Fund (SSNLDF) and we looked at aspects of performance management and governance. This report sets out our key findings.

Financial Position

We have given an unqualified opinion on the financial statements of SSNLDF for 2005/06.

SSNLDF's income for the year from the National Lottery Fund was £2.673 million (2004/05: £2.622 million), New awards made during the year amounted to £2.986 million (2004/05: £4.829 million), though £2.670 million of awards made in previous years to projects were withdrawn. This activity contributed to a surplus for the year of £2.428 million (2004/05: £0.601million deficit), and an increase in net assets from £0.645 million to £3.073 million.

The movements in SSNLDF's financial position are explained by a number of factors, including uncertainty within the industry surrounding the new tax regime (this impacted on the volume of applications received), the disproportionate impact of some of the de-commitments of awards made prior to 2005/06 and the number of applications which fulfilled the relevant criteria (from February to May 2006, no new applications were submitted due to the moratorium and eventual re-launch of the investment process).

Performance Management

Financial Directions in respect of SSNLDF require that Scottish Screen's annual report to the Scottish Ministers includes comment on awards monitoring and evaluation studies. In response to previous audit reports, Scottish Screen has now prepared a second annual monitoring report on the progress of projects subject to Lottery awards.

During 2005/06 the new Chief Executive instigated a full review of all activities of Scottish Screen to ensure they reflected the needs of the sector. The impact on the Lottery Fund was the expansion of the areas to receive support. The Management Commentary in the accounts lists the areas to be developed and launched in 2006/07 and Scottish Screen's commitment to improvement through ongoing review.

Governance

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. Overall the corporate governance and control arrangements for the SSNLDF operated satisfactorily during the year, as reflected in the Statement on Internal Control. There remain opportunities to improve business continuity arrangements and compliance with existing controls, particularly in relation to the timely preparation of bank reconciliations and management accounts. These are subject to continuing internal audit review.

Introduction

1. This report summarises the findings from our 2005/06 audit of the Scottish Screen National Lottery Distribution Fund (SSNLDF). The scope of the audit was set out in our Audit Plan, which was discussed with the Chief Operating Officer on 6 March 2006. This plan described the work we planned to carry out on financial statements, performance and governance.

2. Appendix A of this report sets out the key risks highlighted in this report and the action planned by management to address them.

3. This is the final year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of Scottish Screen during the course of our audit work.

Financial Statements

Our Responsibilities

4. We audit the financial statements and give an opinion on whether:

   - they give a true and fair view of the state of affairs of the SSNLDF for the year;
   - the expenditure and receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers; and
   - they have been prepared properly in accordance with the National Lottery etc. Act 1993 (as amended) and directions made by the Scottish Ministers.

5. We also review the Statement on Internal Control by:

   - considering the adequacy of the process put in place by the Chief Executive as Accountable Officer to obtain assurances on systems of internal control; and
   - assessing whether disclosures in the Statement are consistent with our knowledge of SSNLDF.

Overall Conclusion

6. We have given an unqualified opinion on the financial statements of Scottish Screen's National Lottery Distribution Fund for 2005/06.

7. Following discussion between officials of Scottish Screen and external audit, a date of 30 June 2006 was agreed for the provision of the accounts for audit. Accordingly audit work was scheduled to achieve a certification date that would permit the laying of the accounts before the Scottish and United Kingdom Parliaments by 31 October.

Financial Performance

8. The Fund made a surplus of £2.428 million in 2005/06 (2004/05: deficit of £0.601m). The Fund's Net Asset position increased to £3.073 million (2004/05 £0.645 million).

9. Income allocated to SSNLDF from National Lottery proceeds during the year was £2.673 million (2004/05: £2.622 million), while income returns from previous awards and other sources fell to £0.516 million from £0.918 million, reflecting the volume of successful film investments maturing in 2004/05.

10. The movement in the fund, and the change from deficit to surplus, reflect a significant reduction in the overall value of awards made during the year, together with increase in withdrawals, which were previously funds awarded in previous years. The reduction in awards granted is due to the volume

and quality of applications made. As stated in the Closure Evaluation Report, from February 2006 to May 2006 no new funding applications were submitted due to the moratorium and eventual re-launch of Scottish Screen's lottery investment process. In addition, there is uncertainty within the industry arising from new tax rules. The withdrawals resulted from the early failure or scaling-down of projects subject to awards before 2005/06, or failure to comply with award conditions.

The Issues Arising from the Audit

11. We reported the following issues to the Audit Committee on 23 August 2006:

Pension disclosure

12. The Accounts Direction states that the accounts prepared in respect of National Lottery Distribution activities should follow the requirements of the Government Financial Reporting Manual (FReM). The FReM requires that various pension disclosures (para 7.2.25) are made for senior management which are to be included within the new Remuneration Report. SSNLDF currently classify the Chief Executive as senior management but the accounts do not disclose the required information. The disclosures required for each senior manager who has served during the year include:

- the real increase during the reporting year in the pension and (if applicable) related lump sum at age 60 in bands of £2,500;
- the value at the end of the reporting year of the accrued pension and (if applicable) related lump sum at age 60 in bands of £5,000;
- the value of the cash equivalent transfer value at the beginning of the reporting year to the nearest £1,000;
- the real increase in the cash equivalent transfer value during the reporting year, to the nearest £1,000;
- where the senior manager has a partnership pension account, the employer's contribution to the partnership pension account. (In these circumstances, the disclosures in the first four bullets will not apply.)

Scottish Screen disclosed in the Remuneration Report this information is unavailable. The 2005/06 position was accepted on the basis Scottish Screen will discuss disclosure requirements with the pension fund and actuaries to ensure that all relevant disclosures are met for 2006/07.

Action Plan Point 1

Accounts Direction disclosure requirements

13. The Accounts Direction states at para 6a) vi) that for hard commitments a breakdown of the provision for the grant commitments should be reported separately for each year up to and including 5 years and for over five years. This information is not provided. The accounting policies under Accounting for funding awards have been expanded to include the following, "Due to the nature of the projects supported it is not possible to reliably identify creditors over 12 months, therefore all hard commitments payable are prudently recognised in the balance sheet as current liabilities." Scottish Screen has confirmed that it will take account of this reporting requirement in the future development of a new management information and reporting system.

Action Plan Point 2

De-commitment of awards

14. Scottish Screen has improved its project review procedures in recent years, and this has contributed to the more timely de-commitment of awards that are no longer appropriate. However, draft accounts did not properly reflect two awards (£250,000 and £12,750) that had been made prior to 1 April 2005 but which were withdrawn during 2005/06. The accounts were amended for £250,000, while £12,750 was accepted as an unadjusted error. Scottish Screen explained that the manual system for identifying the withdrawal of prior year awards and notifying finance had broken down due to simple human error. Scottish Screen risk missing future de-commitment decisions without implementing additional controls e.g. a year-end review of committee minutes to identify all de-commitments have been identified and reported to finance.

Action Plan Point 3

Reconciliation of movement in funds

15. In 2004/05 Scottish Screen identified an unexplained difference of £15,000 within the 'Grants paid' line of the Reconciliation of Movement in Funds for the Year in the accounts. Following conclusion of that audit, around £7,000 of that figure was identified through a review of the payments made over the previous 2 years (2003/04 and 2004/05). The outstanding balance has still to be resolved, and is reflected within the grants paid figure £2.58 million. Scottish Screen continue to investigate the discrepancy, and the Chief Operating Officer has committed to resolving the unreconciled difference in 2006/07.

Action Plan Point 4

Balances with Scottish Arts Council (SAC)

16. The accounts include some old debtor balances with SAC, amounting to £36,575 and relating to investment returns received since Scottish Screen succeeded SAC as the relevant distributing body in 2000. This balance has not moved since 31 March 2005. Additionally, included within creditors is £63,372 outstanding on awards committed when SAC was the distributing body: again, this has not moved from the previous year. It is now 6 years since those awards were made. The Chief Operating Officer has confirmed that Scottish Screen will continue discussions with SAC to clear the debtor balance, and that the creditor balances are still valid but are already under review in 2006/07.

Action Plan Point 5

Internal audit costs

17. In 2004/05, we highlighted that no recharge had been made from Scottish Screen's core account to the NLDF for the cost of internal audit services in respect of Lottery income and expenditure. At a rough estimate, the amount concerned was £2,000. The same issue arose again this year. To ensure that the account includes all relevant charges, internal audit costs should, in future, be re-charged to the SSLNDF account.

Action Plan Point 6

Statement on Internal Control

18. As part of our responsibilities we are also required to review whether the statement on internal control prepared by the accountable officer reflects the Commission's compliance with Scottish Executive guidance. We are required to report if it does not meet the requirements specified or if the statement is misleading or inconsistent with other information of which we are aware from the audit of the financial statements. There were no issues that we considered to warrant inclusion in our report.

Performance Management

Introduction

19. This section covers our assessment of the way in which the Commission secures best value in the use of its resources. This year we focused on two main areas:

- awards monitoring and evaluation; and
- Best Value.

Monitoring and evaluation

20. The Financial Directions in respect of SSNLDF require that Scottish Screen's annual report to Scottish Ministers includes a report on awards monitoring and evaluation studies. Scottish Screen has prepared a report and this is appended to the annual report and accounts of the SSNLDF. Information on the evaluation process is included on page 3 of the annual report and accounts.

Best Value

21. Since April 2002 there has been a duty of Best Value on Accountable Officers to *'ensure arrangements are in place to secure Best Value'*. High level guidance was issued in May 2003, followed by more detailed draft secondary guidance in August 2003. This duty can be described as:

- to make arrangements to secure continuous improvement in performance (while maintaining an appropriate balance between quality and cost);
- to have regard to economy, efficiency and effectiveness, and the equal opportunity requirements; and
- to contribute to the achievement of sustainable development.

22. In May 2005, Ministers decided that they would not bring forward legislation which extends Best Value in the wider public sector. However, Ministers do wish to encourage and embed the principles of Best Value across the wider public sector, and revised guidance was issued in May 2006.

23. For 2005/06 Audit Scotland is reviewing how well advanced arrangements are in place by public bodies, across the central government sector, to demonstrate Best Value and to identify areas of good practice. This work is ongoing and a copy of the report will be provided to Scottish Screen for information once complete.

24. Best Value principles are intended to inform and reinforce organisations' efforts towards achieving continuous improvement in the performance of their functions. During 2005/06 the new Chief Executive instigated a full review of all activities of Scottish Screen to ensure they reflected the needs of the sector. The impact on the Lottery Fund was the expansion of the areas to receive support. The Management Commentary in the accounts lists the areas to be developed and launched in 2006/07 and Scottish Screen's commitment to improvement through ongoing review. To embed the principles of Best Value, Scottish Screen should examine the principles and guidance issued on Best Value as part of their ongoing reviews and consider their impact on the distribution of Lottery Funds.

Action Plan Point 7

Governance

Introduction

25. This section sets out our main findings arising from our review of your corporate governance as it relates to:

- system on internal control; and
- review of internal audit.

System on internal control

26. The internal auditors for Scottish Screen provided the opinion, in their Annual Internal Audit Report for 2005/06, that Scottish Screen has adequate and effective risk management, control and governance processes to manage its achievements of the organisation's objectives.

27. In our 2004/05 report we commented that in March 2005, Scottish Screen implemented a new Lottery Funding application and decision-making process. The new process, introduced after lengthy consultation with stakeholders in the Scottish production community, was intended to be more expeditious and transparent than its predecessor. Internal Audit, as noted in paragraph 31 reviewed National Lottery Funding and Expenditure and as part of our audit work we test a sample of awards approved to ensure appropriate approval procedures have been followed. No issues were raised in relation to the application and decision making process.

28. In 2005/06, SSNLDF incurred legal fees of over £70,000 with a firm of solicitors in London. The majority of SSNLDF's legal fees have been paid to this solicitor since 2000 but there has not been a recent formal review of service received or a tendering process carried out. Scottish Screen has an approved policy that all contracts in excess of £10,000 should be tendered for. In 2004/05, we reported that legal fees paid to a legal firm (different from the London firm) did not comply with these policies but acknowledged the specific circumstances of advice being provided. In addition to the risk of not following their own procurement and contracting procedures, Scottish Screen risks not obtaining, or being able to demonstrate that it has obtained, value for money for legal services. Arrangements should be reviewed during 2006/07 to ensure that this agreement has been subject to appropriate procedures.

Action Plan Point 8

Fraud and corruption arrangements

29. No frauds were identified by Scottish Screen in respect of SSNLDF in 2005/06.

Review of internal audit

30. Scottish Screen recognises that internal audit is a key element of the internal control system set up by management. A strong internal audit function is necessary to ensure the continuing effectiveness of the internal control system established. To maximise the reliance that external audit can place on internal audit and to avoid duplication of effort, the adequacy of internal audit is assessed each year.

31. Internal audit services are provided by Wylie & Bisset. An assessment was made of the work of internal audit and we were able to conclude we could rely on the work carried out as proposed in our audit plan. Wylie & Bissett audit carried out various reviews of Scottish Screen in 2005/06, including corporate governance, budgetary and financial controls, IT systems and National Lottery income and expenditure. They reported delays with preparing bank reconciliations and management accounts and the lack of a documented business continuity plan and disaster recovery plan. We note that in prior years both internal and external audit have reported delays with preparation of bank reconciliations and management accounts. We understand that actions are now being undertaken to address certain of these issues, including the restructuring of the Finance team and reorganisation of responsibilities therein. These issues were discussed at Audit Committee meetings and progress against action points is monitored at each Audit Committee through Internal Audit follow-up reports.

Looking Forward

32. Scottish Screen (in its role of managing the Lottery Fund) faces challenges in 2006/7, including the following:

    - Scottish Screen and the Scottish Arts Council are to merge to form a new body, Creative Scotland. The Management Commentary in the accounts states that Scottish Screen's priority in this is to ensure that Creative Scotland addresses the specific needs of the screen industries to ensure both the sector and wider Scottish economy benefit from this development.
    - As mentioned in paragraph 24, during 2005/06 the new Chief Executive instigated a full review of all activities of Scottish Screen and the impact on the Lottery function was the expansion of the areas to receive support. The Management Commentary in the accounts lists the areas to be developed and launched in 2006/07 and Scottish Screen's commitment to improvement through ongoing review.

Appendix A: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para. No	Risk Identified	Planned Action	Responsible Officer	Target Date
1	12	Pension disclosures in the Remuneration Report do not fully comply with the FReM.	The Chief Operating Officer will contact the actuaries to establish the mechanism of accessing this information for inclusion within Financial Statements for 2006/07.	Chief Operating Officer	28 February 2007
2	13	Disclosure of award creditors does not comply with the Accounts Direction requirement to state when these will fall due.	Scottish Screen has satisfied the Accounts Direction as far as is reasonably practicable by the expansion of the section 'Accounting for funding awards' within the accounting policies to include the following: "Due to the nature of the projects supported it is not possible to reliably identify creditors over 12 months, therefore all hard commitments payable are prudently recognised in the balance sheet as current liabilities." Scottish Screen will consider this requirement in the development of the CRM system.	Chief Operating Officer	31 March 2007

Action Point	Refer Para. No	Risk Identified	Planned Action	Responsible Officer	Target Date
3	14	It was established that a material de-commitment of a prior year award had not been notified to Finance, creating a material error in early drafts of the accounts. Scottish Screen risk not recording future de-commitment decisions without implementing additional controls e.g. a year-end review of committee minutes to identify all de-commitment have been identified and reported to finance.	This was an exceptional instance resulting from an unusual and complex project. Additionally the decision was made during the moratorium period when no investment meetings were being held, these factors resulted in the project not being formally ratified in the minutes of the next meeting held. It was this omission which resulted in the non-notification to Finance. As a further control all minutes will be reviewed on an ongoing basis and at the year end to ensure all de-commitments are identified and notified to Finance.	Chief Operating Officer Investment Administrator	31 March 2007
4	15	The 'grants paid' figure within the Reconciliation of Movement of Funds in the accounts includes £9,000 that Scottish Screen has been unable to reconcile to its awards records for the past two years. There is a risk of incomplete records, or of the payments figure being misstated.	The Senior Accountant will undertake a review to establish the source of this discrepancy and make the appropriate adjustment.	Chief Operating Officer Senior Accountant	31 March 2007
5	16	The accounts include some very old balances with SAC: debtors of £36,575 and creditors of £63,372, which did not move at all during 2005/06. There are risks that these funds, which are owned by SSNLDF, are unavailable for a variety of purposes including cashflow, reallocation, and earning of interest.	There are 2 separate matters here: Debtors - Business Affairs has been in contact with the SAC with regard to concluding this matter, and will continue to chase. The COO has contacted the Finance Director at SAC to escalate the matter and have gained confirmation that this matter will be addressed. We will continue to pursue and are confident of full recovery. Creditors —This relates to projects awarded funding by SAC. We will undertake a review of these projects during the year 2006/07.	Chief Operating Officer Business Affairs Investment Administrator	31 March 2007

Action Point	Refer Para. No	Risk Identified	Planned Action	Responsible Officer	Target Date
6	17	In 2004/05, we highlighted that no recharge had been made from Scottish Screen's account to the NLDF for the cost of internal audit services in respect of Lottery income and expenditure. At a rough estimate, the amount concerned was only £2,000. There was again no re-charge in 2005/06. The accounts risk not showing the accurate costs of administering lottery funds.	We will undertake to make a charge to the NLDF for financial year 2006/07 for a proportion of the Internal Audit Fees, relative to the Lottery aspect of the work.	Chief Operating Officer Senior Accountant	31 March 2007
7	24	Revised Best Value guidance was issued in May 2006. Without a review of the guidance Scottish Screen risk not being able to demonstrate their work on distributing lottery funds meets Best Value principles.	Scottish Screen recognises its responsibilities with regard to Best Value, and will continue to reflect this in undertaking its activities and through its commitment to continuous improvement; effective governance at strategic and operational levels; stakeholder consultation, etc.	Chief Executive Chief Operating Officer	31 March 2007
8	28	There has been no recent tendering process for legal fees, which have been regularly paid to a legal firm in London under a long-standing arrangement. In addition to the risk of not following its own procurement and contracting procedures, Scottish Screen risks not obtaining, or being able to demonstrate that is has obtained, value for money for legal services.	Scottish Screen recognises this point and has considered it in respect of this arrangement: however, it believes that the current arrangement delivers a resource that is both cost-effective and provides a unique level of specific and uncommon specialist knowledge and understanding. During the year 2006/07, Scottish Screen will examine its requirement for legal advice across the organisation and, as required, will invite tenders from prospective companies.	Chief Operating Officer Business Affairs	31 December 2006