



SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW



Scottish Arts Council

Annual Report to the Joint Board and the
Auditor General for Scotland
2007/08

October 2008



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1 Summary

Governance

- The Scottish Arts Council has incurred costs in 2007/08 of £0.223 million on the transition to Creative Scotland. This includes the costs of the Transition Director and the Transition Team. The Creative Scotland Bill fell at stage one of the parliamentary review process on 18 June 2008. On 3 September Scottish Ministers announced their intention to take forward the arrangements for establishing Creative Scotland as part of the Public Services Reform Bill. Creative Scotland will be set up as a company limited by guarantee and a new board of directors and a chief executive will be appointed by April 2009. The company limited by guarantee is expected to become a statutory body by February 2010...
- The Scottish Arts Council has been reluctant to make longer term financial commitments until the future of Creative Scotland was more certain. This has resulted in a number of senior positions being filled on an acting-up or temporary basis.

Performance

- Audit Scotland has continued its roll-out of Best Value reviews in the central government sector and has performed a number of Best Value reviews of Financial Management arrangements in 2007/08. We have not performed this review at the Scottish Arts Council but we will review Audit Scotland's overall findings as part of our 2008/09 audit.
- The Scottish Arts Council launched its Quality Framework in March 2007. The Quality Framework is effectively a set of guidelines for arts organisations. Initial feedback from the arts sector has been positive. The Scottish Arts Council has commissioned an independent review of the Quality Framework and the results of the review are expected in autumn 2008. The Scottish Arts Council will consider the results of the review and, if necessary, revise the Quality Framework by 1 April 2009.

Finance

- Our audit opinions on the truth and fairness of both the Scottish Arts Council Non-Departmental Public Body (SAC NDPB) group annual accounts and the Scottish Arts Council National Lottery Distribution Fund (SAC NLDF) annual accounts are unqualified.
- The SAC NDPB group annual accounts show total expenditure in support of the arts of £48.854 million and net incoming resources of £2.014 million. The SAC NLDF incurred total expenditure of £16.027 million and reported an increase in the fund of £0.909 million.

Conclusion

This report concludes the 2007/08 audit of the Scottish Arts Council. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

This report has been discussed and agreed with the Acting Chief Executive and Finance Director. We would like to thank all members of the Scottish Arts Council's management and staff who have been involved in our work for their co-operation and assistance during our audit visits.

Scott-Moncrieff
October 2008

2 Introduction

2.1 Auditor General and Audit Scotland

The Auditor General for Scotland is responsible for reporting to the Scottish Parliament on how public bodies spend public money, manage their finances and achieve value for money in the use of public funds. In discharging this responsibility the Auditor General appoints central government auditors and sets the terms of their appointment.

Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out his statutory functions, including preparing a Code of Audit Practice which sets out the role and responsibilities of the external auditor.

2.2 Audit appointments

The Auditor General for Scotland has appointed Scott-Moncrieff as external auditor of the Scottish Arts Council for the five year period 2006/07 to 2010/11. This appointment also covers the establishment of Creative Scotland during the five year period.

Under the National Lottery etc Act 1993 (as amended), the Scottish Arts Council is appointed to distribute National Lottery funds for expenditure on or connected with the arts in Scotland. Scottish Ministers' guidance requires the Scottish Arts Council to prepare separate statements of accounts relating to these activities. The Auditor General for Scotland has also appointed Scott-Moncrieff as external auditor of the Scottish Arts Council National Lottery Distribution Fund (SAC NLDF).

The Scottish Arts Council is the sole member of the Centre for Contemporary Arts (CCA), which is a charitable company. Consequently CCA is consolidated into the Scottish Arts Council's group accounts. We have been appointed independently as auditors to CCA.

This annual report summarises our 2007/08 audits of the Scottish Arts Council group and Scottish Arts Council National Lottery Distribution Fund and highlights the key issues arising from our work.

2.3 Independence and ethical standards

Ethical Standard 1 – *Integrity, objectivity and independence*, issued by the Auditing Practices Board (APB), requires that external auditors ensure that the Audit Committee is appropriately informed on a timely basis of all significant facts and matters that bear upon the auditors' objectivity and independence.

In addition to providing the external audit service to the Scottish Arts Council, Scott-Moncrieff also provided the following services to the Scottish Arts Council group:

- External audit and VAT advice to the Centre for Contemporary Arts (CCA) – a subsidiary of the Scottish Arts Council; and
- Internal audit services to the Scottish Arts Council.

The appointment of Scott-Moncrieff as internal auditors to the Scottish Arts Council had been specifically permitted by Audit Scotland. Scott-Moncrieff will not be providing internal audit services for 2008/09 and alternative arrangements will be put in place.

APB Ethical Standard 5 – *Non-audit services provided to audit clients* prohibits the provision of internal audit services to an audit client where it is reasonably foreseeable that the external audit will place significant reliance on the work of internal audit. Whilst, we have reviewed the work of internal audit, we have not placed any significant reliance on their work for the purposes of the audit of the annual accounts.

In addition, to ensure the objectivity of the audit team the following safe guards were put in place:

- The external and internal audit services were undertaken by separate teams, and
- The external audit was subject to an independent partner review.

We can confirm that we have complied with the APB Ethical Standards throughout the audit and that, in our professional judgement, we have remained independent and our objectivity has not been compromised in any way.

2.4 Key risks

Our audits are risk based. This means that we focus our resources on the areas of highest priority or risk to the Board. The key audit issues identified for the 2007/08 audit were summarised in our external audit plan presented to the Audit Committee on 26 October 2007. These audit issues were:

- Creative Scotland
- Centre for Contemporary Arts
- Quality Framework

This report includes our findings in relation to these key issues.

2.5 Scope of the audit

Our audit work can be classified under the following three headings: governance, performance and finance. The main audit objective for each of these areas is summarised below.

2.5.1 Audit areas and audit objectives

Audit area	Audit objective
Governance	To review the Council's governance arrangements in relation to: <ul style="list-style-type: none">• the Council's review of its systems of internal control,• the prevention and detection of fraud and irregularity, and• standards of conduct and prevention and detection of corruption.
Performance	To review the Council's arrangements for managing its performance and for securing economy, efficiency and effectiveness in its use of resources.
Finance	To provide an opinion on the truth and fairness of the Council's financial statements and on the regularity of transactions. To review the Council's financial standing, and financial management arrangements.

The remainder of this report sets out the results of our work in 2007/08. The action plan in section 6 details the recommendations we have made during the year.

3 Governance

3.1 Creative Scotland

The Scottish Government introduced the Creative Scotland Bill to the Scottish Parliament on 13 March 2008 and, if approved, the act would have led to the establishment of a new body, Creative Scotland, to replace the Scottish Arts Council and Scottish Screen.

The Bill fell at Stage one of the Parliamentary process on 18 June 2008. Though Parliament unanimously supported the principles behind the Bill, there was some uncertainty surrounding the financial arrangements in place for the creation of the new organisation. On 3 September 2008 Scottish Ministers announced that the arrangements for establishing Creative Scotland would undergo further parliamentary scrutiny through the Public Services Reform Bill. Creative Scotland will, in the first instance, be incorporated as a company limited by guarantee. A new board and chief executive will be appointed by April 2009. The announcement envisaged that the new organisation would mature into a statutory body by February 2010..

The Scottish Arts Council has been working with Scottish Screen and the Scottish Government towards the move to Creative Scotland and they have taken the following preparatory steps:

- Appointed a Joint Board on 1 February 2007. The Joint Board acts as the governing body of both the Scottish Arts Council and Scottish Screen. Following the Ministerial announcement it is expected that the Joint Board will be tasked with the winding down of both Scottish Screen and the Scottish Arts Council. The timetable for this wind down has not yet been agreed and it may be that these bodies will require to continue beyond April 2009 in some form.
- Appointed a Transition Director.
- Established a Task Force (a sub-group of the Board) and the CEO Directorate (Scottish Arts Council's Acting Chief Executive, Scottish Screen's Chief Executive and the Transition Director) to deal specifically with the creation of Creative Scotland.
- Mapped current activities, systems and processes.

Since the Bill fell on 18 June 2008, the Transition Team has continued its work towards the move to Creative Scotland, including the development of a draft Corporate Plan, ongoing work on the identification of costs of change and preparing a report modelling the costs and benefits of various options for going forward. The modelled costs were submitted to Scottish Ministers in August 2008 and further information is expected from the Scottish Government. The Transition Team continue to work up these provisional costs to a more detailed proposal.

The Scottish Arts Council has attempted to limit the permanent commitments it makes until the future of Creative Scotland becomes more certain. In particular:

- The Scottish Arts Council's Chief Executive is employed on an acting up basis
- The potential for and timing of a potential relocation of premises is unknown.
- Long term staffing requirements are not known and new staff are employed on a temporary basis.

Whilst we accept and understand the reasons for delaying permanent appointments and avoiding longer term commitments, it is unfortunate that these temporary arrangements have now been in place for over 19 months. Further delays to the formation of Creative Scotland could have a detrimental impact on the continuing activities of the Scottish Arts Council.

The Scottish Arts Council was appointed as a lottery distributor by the National Lottery etc Act 1993 (as amended) and this responsibility will not automatically transfer to Creative Scotland, as a statutory instrument will be required. However, the Department for Culture, Media and Sport (DCMS) has provided details of future funding projections until 2012/13 and the Scottish Arts Council is confident that responsibility for National Lottery funding will be transferred to the new body.

3.2 Acting Chief Executive's remuneration

The current Chief Executive has been undertaking the role on an acting-up basis since February 2007. The Acting Chief Executive's pay has been based on a normal employee's scales with an additional acting-up allowance. The Acting Chief Executive's performance is reviewed by the Chair.

The Joint Board has a Remuneration Committee and the committee has delegated authority for setting the remuneration of the Chief Executives of both the Scottish Arts Council and Scottish Screen. The Remuneration Committee did not set the Scottish Arts Council's Acting Chief Executive's remuneration during the year as the post was filled on an acting-up basis.

The Acting Chief Executive has been in this post for over 19 months and, with the potential delay to Creative Scotland, will be in place for a further period. In line with best practice, we recommend that the Acting Chief Executive's remuneration is set by the Remuneration Committee.

Action Plan – 6.2.1

3.3 Statement on Internal Control

The framework of internal controls operating within the Scottish Arts Council is reported within the Statement on Internal Control (SIC) included within each set of annual accounts. No significant areas have been identified which require to be raised within the SIC.

We are satisfied that:

- the contents of the SIC are not inconsistent with information gathered during the course of our normal audit work, and
- the statement is in line with Scottish Ministers' guidance

3.4 Risk management

Risk management is important to the establishment and regular review of systems of internal control. The Scottish Arts Council has a Risk Management Policy and Risk Management Procedures in place. These were approved in 2005/06. A risk register is also in place and this is maintained by the Finance Director, who along with senior management is responsible for reviewing and updating the risk register on a monthly basis. Changes to the action plan and risk register are reported to the Audit Committee at quarterly meetings. Following discussion at the Audit Committee the report is presented at the Joint Board meetings.

We have concluded that the Scottish Arts Council has satisfactory risk management systems in place but have identified a number of recommendations for improvements:

- The Risk Management Strategy and Policy should be reviewed annually;
- The risk in the risk register should be linked to corporate objectives; and
- Specific deadlines should be provided for mitigating actions.

Action Plan – 6.2.2

3.5 Internal audit

Internal audit is a key component of the Council's corporate governance arrangements. As reported in section 2.3, the Council's internal audit service is provided by Scott-Moncrieff. It would not be appropriate for us to review the internal audit service provided by the firm in 2007/08, however, we can confirm that the internal audit service have completed their work plan for the year.

During 2007/08 we considered the following internal audit reports:

- Core Financials Systems Review
- Transition to Flexible Funding
- Business Continuity Planning

- Grant Creditors
- Change Management
- Follow-up Report

We considered the impact of the findings from these reports on our own risk assessments. We did not place any significant reliance on the work of internal audit.

To ensure compliance with the Scott-Moncrieff ethical standards, the external and internal audit services from Scott-Moncrieff were undertaken by separate teams and the external audit service has been subject to an independent partner review. These arrangements have also been agreed with Audit Scotland.

Scott-Moncrieff, in conjunction with the Audit General for Scotland, has agreed not to act as internal auditors for 2008/09.

3.6 Prevention and detection of fraud and irregularity

We are required to consider the arrangements made by management for the prevention and detection of fraud and irregularity. The Scottish Arts Council has a fraud plan and fraud response procedures in place. No frauds were reported identified during the year.

We are pleased to report that we identified no issues of concern in relation to the arrangements for the prevention and detection of fraud.

3.7 Standards of conduct, integrity and openness

We are required to consider the arrangements made by management in relation to standards of conduct and the prevention and detection of corruption.

Due to the nature of the arts sector, the Scottish Arts Council provides grants to organisations or individuals which are also linked to the Scottish Arts Council, e.g. as external advisors. The Scottish Arts Council has strong procedures in place to identify any potential conflict of interests. We reviewed the Council's Declarations of Interests for 2007/08 and confirmed that these were up to date. The related parties disclosures in both set of annual accounts were found to be materially correct.

We are pleased to report that our audit identified no issues of concern in relation to standards of conduct and the prevention and detection of corruption.

4 Performance

4.1 Best Value

The Scottish Government defines Best Value as:

"[seeking to] secure continuous improvement in the performance of functions by public service organisations. Continuous improvement seeks to balance quality and cost considerations, and is achieved with regard to economy, efficiency, effectiveness, the equal opportunities arrangements, and sustainable development." ¹

Following the successful introduction of the Best Value regime to local government, Scottish Ministers introduced a non-statutory duty to deliver Best Value on all public sector accountable officers. Audit Scotland has committed to developing the Best Value agenda across the public sector and is beginning to formalise this work in the central government sector.

Audit Scotland is developing a programme of audit toolkits which are to be used by appointed auditors across central government. Audit Scotland aims to develop seven toolkits initially to determine how efficiently and effectively central government bodies are using their resources within Best Value standards. These toolkits are to be rolled out as part of the external audit programme from 2007/08 onwards. The seven toolkits cover the areas of:

- Financial management;
- Efficiency;
- Information management;
- Procurement;
- Asset management;
- Performance management; and
- People management.

The Financial Management toolkit was the first toolkit to be rolled out by Audit Scotland in 2007/08. The toolkit states that effective financial management underpins service quality and improvement, is an essential element of good corporate governance, and provides a clear accountability basis for the stewardship of resources.

Best Value reviews of financial management arrangements were performed at a number of central government bodies in 2007/08. We have not performed this review at the Scottish Arts Council due to the transition to Creative Scotland. We plan to review the results of the national study as part of our 2008/09 audit.

¹ <http://www.scotland.gov.uk/Topics/Government/PublicServiceReform/14838/564>

4.2 Corporate Plan

The Joint Board approved its Corporate Plan 2007-09 in March 2007 which set out the priorities, actions and targets for the period. The Scottish Arts Council's normal arrangements are that six-monthly meetings take place to monitor progress against the plan. Progress against the Corporate Plan has been monitored by senior management during the year and, as requested, progress has also been reported to the Scottish Government. However, due to resources being diverted to Creative Scotland transition, the six-monthly meeting did not take place and progress against the Corporate Plan was not reported to the Joint Board.

We recommend that the Scottish Arts Council recommence its six-monthly monitoring meetings and that the progress against the Corporate Plan is reported to the Joint Board.

Action Plan – 6.2.3

4.3 Quality Framework

After a consultation exercise, the Scottish Arts Council launched its Quality Framework in March 2007. The Quality Framework is effectively a set of guidelines for arts organisations. Arts organisations in receipt of Scottish Arts Council grants are expected to comply with these guidelines. Foundation organisations are required to report to the Scottish Arts Council on all areas of the Quality Framework and any organisation funded on a flexible basis is required to report primarily against Artistic Leadership.

The Quality Framework has now been in place for over a year, with the Scottish Arts Council having been through a full funding cycle with its foundation and flexible funded organisations. Initial feedback from the arts sector has been positive. The Scottish Arts Council has commissioned external consultants to perform an independent review of the Quality Framework and the results of the review are expected in autumn 2008. The Scottish Arts Council will consider the results of the review and make any required revisions to the Quality Framework by 1 April 2009.

5 Finance

5.1 Annual accounts

Scottish Ministers guidance requires the Scottish Arts Council to prepare separate accounts for its Non-Departmental Public Body account (SAC NDPB) as well as its National Lottery Distribution Fund (SAC NLDF) account. The SAC NDPB is a group account and incorporates the Scottish Arts Council's subsidiary – Centre for Contemporary Arts (CCA).

We are pleased to report that both sets of final annual accounts were approved by the Joint Board on 24 October 2008 and submitted to Audit Scotland by the deadline of 31 October 2008.

In preparing the annual accounts, the Scottish Arts Council is required to comply with Scottish Ministers guidance as stated in the Accounts Direction and the Government Financial Reporting Manual (FRoM). In preparing the SAC NDPB annual accounts, the Scottish Arts Council is also required to comply with the Statement of Recommended Practice issued by the Charities Commission in 2005 (Charities SORP 2005). The SAC NDPB 2007/08 accounts and the SAC NLDF 2007/08 accounts comply with the various requirements in all material respects.

5.2 Unqualified audit opinion

We are pleased to report that we plan to issue unqualified audit opinions on the truth and fairness of both sets of annual accounts.

We also plan to issue unqualified audit opinions on the regularity of transactions for both sets of annual accounts. There have been no modifications to our auditors' reports.

5.3 Financial performance and position

5.3.1 Scottish Arts Council NDPB group annual accounts

The table below summarises the key financial information for the SAC NDPB 2007/08 group annual accounts.

	2007/08 £000s	2006/07 £000s
Grant-in-aid	48,519	62,474
Other income	2,089	3,153
Total incoming resources	50,608	65,627
Total support to the arts	48,792	66,900
Governance	62	65
Total outgoing resources	48,854	66,965
Sub-total	1,754	(1,338)
Reversal of notional interest	260	237
Loss on disposal of National Theatre for Scotland	-	(430)
Net incoming / (outgoing) resources	2,104	(1,531)
Net assets	8,503	6,489

National Performing Companies were funded by the Scottish Arts Council until 31 March 2007 when responsibility for funding transferred to the (then) Scottish Executive. This has resulted in a significant decrease in both incoming resources and outgoing resources in 2007/08.

The net incoming resources in 2007/08 is principally due to timing differences. In 2006/07, the Scottish Arts Council provided some advances on grants agreed for 2007/08. In line with the Scottish Arts Council's accounting policy, it recognised the advances as expenditure in 2006/07 if the advance grants were used to fund activities in 2006/07. Where the grant was used to fund 2007/08 activities, the advance was treated as a debtor in the 2006/07 annual accounts and then as expenditure in the 2007/08 annual accounts. There were no advance grants treated as expenditure in the Scottish Arts Council's 2007/08 annual accounts.

5.3.2 Scottish Arts Council NLDF annual accounts

The table below summarises the key financial information for the SAC NLDF 2007/08 annual accounts.

	2007/08 £000s	2006/07 £000s
Lottery proceeds	16,737	16,884
Other income	184	158
Total incoming resources	16,921	17,042
Grant expenditure and art services	14,986	19,403
Other expenditure	1,041	1,189
Total outgoing resources	16,027	20,592
Reversal of notional interest	15	-
Increase / (decrease) in fund	909	(3,550)
Net assets	13,639	12,845

The Accounts Direction in relation to the SAC NLDF specifies the accounting policy to be adopted for grant expenditure. Grant expenditure is recognised where a grant offer has been made and accepted. Where an offer has been made but not accepted, this is shown as a commitment. The movement in the year is largely due to timing differences of grant acceptances.

5.4 Impact of Creative Scotland

5.4.1 Going concern basis

As highlighted above, the Scottish Arts Council and Scottish Screen will potentially be replaced by a new body – Creative Scotland. Financial Reporting Standard 18 – *Accounting Policies* (FRS 18) requires the Joint Board to assess whether there are any uncertainties about the Scottish Arts Council's ability to continue as a going concern and, if so, to disclose these uncertainties in the financial statements. The potential establishment of Creative Scotland and the winding up of the Scottish Arts Council has created uncertainty over the future of the Scottish Arts Council and this has been disclosed in the accounting policies in note 1 to the annual accounts. The directors consider the going concern basis to be appropriate as assets, liabilities and operations of the Scottish Arts Council are likely to transfer to the new body.

5.4.2 Transition costs

The cost of the transition work is shared between the Scottish Arts Council and Scottish Screen, with the Scottish Arts Council funding the majority of the costs. Note 4 to the group accounts shows that Scottish Arts Council has incurred costs of £0.223 million in relation to transition during the year.

5.5 Accounting and internal control systems

No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the Scottish Arts Council's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the accounts.

However we did identify one minor control weakness in that the control account reconciliations are not always reviewed and signed off by an independent officer for accuracy and completeness.

Action plan – 6.2.4

5.6 Annual accounts preparation process

We are pleased to report that we were presented with draft annual accounts and supporting working papers by the agreed date.

We reported in our 2006/07 Annual Report that the draft annual accounts contained a high number of errors. We are pleased to report that the draft 2007/08 annual accounts were of a higher quality. However, further improvements can be made and management plan to review the process in time for the preparation of the 2008/09 annual accounts.

Action plan – 6.3.5

Working papers to support the annual accounts were of an excellent standard and we were pleased by the assistance given to us by all Scottish Arts Council staff.

5.7 Provision for dilapidations

The Scottish Arts Council lease of its offices at 12 Manor Plan requires the Scottish Arts Council to return the property in a particular condition. The Scottish Arts Council is required to recognise the liability for the costs involved in returning the property to this condition (dilapidations) at the balance sheet date. The initial draft of annual accounts included a provision for dilapidations of £200,000, which was split between the SAC NDPB and SAC NLDF annual accounts. This estimate was based on the costs of the Scottish Arts Council's previous last office move. Due to changes in property prices we requested an external

valuation which the Scottish Arts Council agreed to obtain. The external valuation was £161,000 greater than the Scottish Arts Council's original estimate and the annual accounts were subsequently adjusted. The provision for dilapidations was split between the SAC NDPB and SAC NLDF on a 67:33 basis.

5.8 Write-down of negative goodwill

The Scottish Arts Council became the sole member of Centre for Contemporary Arts (CCA) on 21 February 2006. Since then, CCA has been effectively a subsidiary of the Scottish Arts Council for financial reporting purposes and therefore the Scottish Arts Council has prepared group accounts which consolidate CCA. The consolidation gave rise to negative goodwill as the Scottish Arts Council group effectively acquired CCA for nil consideration.

The Scottish Arts Council has previously adopted a policy of writing-down the negative goodwill over 10 years. Financial Reporting Standard 10 – *Goodwill and Intangibles Assets* (FRS 10) requires negative goodwill to be written down in line with the assets to which it relate, which in this case is the CCA building. The Scottish Arts Council has revised the timeline for the write-down and is now amortising the negative goodwill in line with the remaining useful life of the building.

5.9 Audit adjustments

Other than the adjustment to the provision for dilapidations and goodwill set out above, our audit adjustments related to presentational and disclosure adjustments. All of our proposed adjustments were processed and there were not any unadjusted misstatements.

5.10 Centre for Contemporary Arts

5.10.1 SAC's future involvement in the Centre for Contemporary Arts

CCA, a charitable company, is recognised as one of Europe's leading contemporary galleries, and in addition works with a range of art forms including visual arts, performance, live art, dance, music, talks and events. As highlighted above the Scottish Arts Council is the sole member of CCA and therefore CCA is consolidated into the Scottish Arts Council's group accounts.

The CCA is not considered part of the Scottish Arts Council's core activities and the Scottish Arts Council has been considering different options to dispose of both its interest in the building and the subsidiary. There have been no firm plans agreed as at the date of this report.

5.10.2 Repayment of European grant

CCA received a European Regional Development Fund (ERDF) grant of approximately £8 million between 1997-99 towards the development of the CCA building. The conditions of the grants restricted the use of the grant for the agreed purpose and also required CCA to maintain adequate records to demonstrate that it had complied with the conditions of the grant.

The European Court of Auditors audited the grant to CCA in 2005 as part of a larger review of the ERDF programme. The European Court of Auditors concluded that CCA had not complied with a number of the requirements of the original grant. Importantly they could not find sufficient evidence to demonstrate that adequate tendering procedures had been applied. This led to the European Commission requesting a repayment of £932,000. CCA in conjunction with SAC appealed the initial claim for repayment and were of the opinion that no liability existed. CCA received notification in July 2008 that its appeal had not been wholly successful and that the European Commission was still looking for repayment of £592,000.

As project partner and sole member of CCA, the Scottish Arts Council has accepted responsibility for the liability and agreed to provide CCA with an additional grant to meet the repayment. This additional grant was approved by the Joint Board on 28 August 2008.

The demand for repayment and the additional SAC grant to CCA have been accounted for as adjusting post balance sheet events in the CCA's financial statements. The financial statements show the liability to repay the grant as well as the additional grant income from the Scottish Arts Council. The liability for the ERDF repayment is also shown in the Scottish Arts Council group accounts.

5.11 Arts Council Retirement Plan

The Scottish Arts Council is a member of the Arts Council Retirement Plan which is a multi-employer scheme. The scheme's actuaries cannot identify the assets and liabilities of each member on a reasonable and consistent basis and therefore SAC, as required by Financial Reporting Standard 17 – *Retirement Benefits* (FRS 17) has accounted for the scheme as a defined contribution scheme. This means that any assets or liabilities in the scheme are not shown on the Scottish Arts Council's balance sheet.

However, the Scottish Arts Council is required to disclose the overall position on the Arts Council Retirement Plan and this is shown in note 5.3, Actuarial Valuation, to the annual accounts.

The Scottish Arts Council's solicitors have advised us of a potential claim by the trustees against the Council in relation to the move to Creative Scotland. The switch to Creative Scotland may mean that any liabilities on the pension scheme become payable as it may be considered a "transfer to another employer".

If the pension scheme rules prohibit the Scottish Arts Council employees from continuing to be members of the Arts Council Retirement Scheme on their transition to Creative Scotland, then the liability will become payable. This would also be the case if the Joint Board decides to make alternative pension arrangements.

We recommend that the Council clarifies the position in relation to a future funding liability to the Arts Council Retirement Plan.

Action Plan – 6.2.5

5.12 Recharges to National Lottery Distribution Fund

We are pleased to report that the Council has revised its methodology for recharging expenditure to the NLDF. The method now in place is based on the number of grant awards made as well as the value of these grants in the year and provides a more reasonable basis for the recharges made.

5.13 International Financial Reporting Standards (IFRS)

The 2007 budget speech intimated the decision to adopt IFRS for public sector accounting by 2008/09. During the 2008 Budget speech the Chancellor postponed the implementation until 2009/10.

It is likely that charitable NDPBs will not be expected to prepare IFRS annual accounts in the short term. Charitable NDPBs are expected to receive an updated Accounts Direction which will require compliance with the IFRS based Financial Reporting Manual (iFReM). The iFReM will however require charitable NDPBs to follow the Charities SORP 2005 which is based on UK financial reporting standards. Should Creative Scotland not obtain charitable status, it would be required to prepare IFRS compliant annual accounts.

The SAC NLDF annual accounts are not prepared under the Charities SORP 2005 and it is expected that these will require to be prepared under IFRS once these are adopted in the public sector.

6 Action Plan

Our annual report action plan details the control weaknesses and opportunities for improvement that we have identified during 2007/08. These are the issues that we believe need to be brought to the attention of the Joint Board.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

6.1 Priority rating

To assist the Joint Board in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. The rating structure is summarised as follows:

- Priority 1 High risk, material observations requiring immediate action.
- Priority 2 Medium risk, significant observations requiring reasonably urgent action.
- Priority 3 Low risk, minor observations which require management action.

6.2 Issues from our 2007/08 audit

Title	Issue Identified	Risk and Recommendation	Management Comments
<p>6.2.1</p> <p>Acting Chief Executive</p>	<p>The Remuneration Committee has delegated authority for setting the remuneration of the Chief Executives of both Scottish Arts Council and Scottish Screen. The Remuneration Committee did not set the remuneration for the Acting Chief Executive's of Scottish Arts Council as the post was filled on an acting-up basis.</p>	<p>The Acting Chief Executive has been in this post for over 19 months and, with the potential delay to Creative Scotland, could be in place for some time. In line with best practice we recommend that the Acting Chief Executive's remuneration is set by the Remuneration Committee.</p> <p>Priority 2</p>	<p>Agreed.</p> <p>Responsible individual: Chair of the Audit Committee</p> <p>Implementation date: November 2008</p>
<p>6.2.2</p> <p>Risk management</p>	<p>The risk management system is generally robust, however we have identified a number of possible improvements.</p>	<p>There is a risk that the risk management processes are not being updated on a basis that ensures that it is fully reflective of the Council's current situation and in compliance with best practice in risk management</p> <p>We recommend that:</p> <ul style="list-style-type: none"> • An annual update of risk management strategy and policy is undertaken; • The risk register is enhanced to include a link of risks to corporate objectives; and • Specific deadlines are provided for mitigating actions. <p>Priority 3</p>	<p>Agreed.</p> <p>Responsible individual: Finance Director</p> <p>Implementation date: January 2009</p>

Title	Issue Identified	Risk and Recommendation	Management Comments
<p>6.2.3</p> <p>Performance monitoring</p>	<p>Though progress against the Corporate Plan was monitored by senior management during the year, the Scottish Arts Council did not have its normal full six-monthly meetings. This was due to resources being diverted to Creative Scotland transition. Progress against the Corporate Plan was not reported to the Joint Board.</p>	<p>The monitoring of corporate objectives during the year allows the Joint Board to take corrective action where the organisation is not on track to meet its objectives. In the absence of regular monitoring and reporting there is a risk that the Scottish Arts Council will not meet its corporate objectives.</p> <p>We recommend that the Council recommence its six-monthly monitoring meetings and the progress against the Corporate Plan is reported to the Joint Board.</p> <p>Priority 2</p>	<p>That six month reporting has been re-introduced with a report against objectives for 12 months 2007/08 going to the board in September and six month against 2008/09 scheduled to go to the board in November or December 2008.</p> <p>Responsible individual: Director of Planning and Communications</p> <p>Implementation date:</p>
<p>6.2.4</p> <p>Control account reconciliations</p>	<p>The finance team have monthly procedures in place which include control accounts reconciliations. Bank and grant accounts reconciliations are reviewed however other control account reconciliations are not always reviewed and signed off by an independent officer for accuracy and completeness.</p>	<p>There is a risk that the control accounts contain errors or omissions.</p> <p>We recommend that a second, independent person reviews the control account reconciliations and initials these as checked.</p> <p>Priority 3</p>	<p>Agreed.</p> <p>Responsible individual: Finance Director</p> <p>Implementation date: September 2008</p>

Title	Issue Identified	Risk and Recommendation	Management Comments
<p>6.2.5</p> <p>Retirement plan</p>	<p>It is not clear whether Scottish Arts Council's employees will be able to remain members of the Arts Council Retirement Scheme If the transition to Creative Scotland goes ahead.</p>	<p>There is a risk that the move to Creative Scotland could crystallise the Scottish Arts Council's share of the liability on the scheme.</p> <p>We recommend that the Council obtain legal clarification on whether the pension scheme rules prohibit the Scottish Arts Council's employees from continuing to be members of the Arts Council Retirement Plan if the transition to Creative Scotland goes ahead.</p> <p>Priority 1</p>	<p>Agreed.</p> <p>Responsible individual: Transition Director</p> <p>Implementation date: In advance of the set-up of Creative Scotland</p>
<p>6.2.6</p> <p>Grant Claims Monitoring</p>	<p>The Council monitors compliance with grant conditions by inspecting documentation produced by claimant.</p> <p>Physical verification is only undertaken for high level and high cost events/projects.</p>	<p>There is a risk that recipients of grants are not undertaking the tasks for which grants were approved and thus defrauding the Council.</p> <p>We recommend that a sample of awards are physically verified each year for legitimacy.</p> <p>Priority 2</p>	<p>A target proportion of events and activities to be physically verified in 08/09.</p> <p>Responsible individual: Co-Director of Arts</p> <p>Implementation date: November 2008</p>

6.3 Follow-up of previous external audit recommendations

Title	Original issue and recommendation	Original management response	Latest update position
<p>6.3.1</p> <p>Balances with Scottish Screen</p>	<p>There is a risk that these old balances are incorrect or misstated.</p> <p>Balances between Scottish Screen and Scottish Arts Council should be agreed and cleared.</p> <p>Priority 3</p>	<p>This will be addressed as part of the merger</p> <p>The previous Chief Executive considered it unnecessary to resolve these as they will disappear on the merging of SAC and SS balance sheets into Creative Scotland's.</p> <p>Responsible individual: Finance Director</p> <p>Implementation date: In line with merger</p>	<p>We have confirmed with the Head of Finance that these have now been removed.</p> <p>Recommendation implemented.</p>
<p>6.3.2</p> <p>Valuation of fixed assets</p>	<p>The Scottish Arts Council's group is currently misstating the value of its assets as they have not been updated as at 31 March 2007.</p> <p>We recommend that the Scottish Arts Council apply indexation to its fixed assets in future. We do not consider the difference to be material for the purposes of the 2007/08 financial statements.</p> <p>Priority 2</p>	<p>The SAC approach has been to work on the disposal of non core assets, such as the building referred to. In the event that disposal is not achieved by March 2008, indexation will be applied.</p> <p>Responsible individual: Finance Director</p> <p>Implementation date: March 2008</p>	<p>The property is due for an interim valuation in 2008/09 and the Scottish Arts Council plans to obtain this.</p> <p>We will follow this recommendation up during our 2008/09 audit.</p> <p>Responsible individual: Finance Director</p> <p>Implementation date: March 2009</p>

Title	Original issue and recommendation	Original management response	Latest update position
<p>6.3.3</p> <p>Financial operating procedures</p>	<p>As there are no up to date procedures in the Finance Department staff may be adopting inconsistent practices which may lead to a higher risk of errors.</p> <p>We recommend that the financial procedures are updated to reflect current practice.</p> <p>Priority 2</p>	<p>These procedures have been updated in practice but the changes not formally incorporated into a single document. This will now be done.</p> <p>Responsible individual: Finance Director</p> <p>Implementation date: October 2007</p>	<p>The financial procedures have not yet been completed but management plan to address this.</p> <p>Original recommendation has not yet been addressed.</p> <p>Responsible individual: Finance Director</p> <p>Implementation date: November 2008</p>
<p>6.3.4</p> <p>Authorised signatory list</p>	<p>The risk is that grants and payments are being approved fraudulently and/or by the wrong person(s).</p> <p>We recommend that the Grants Administration department are provided with an authorised signatory list to use when checking for grant approval and authorisation of payments.</p> <p>Priority 3</p>	<p>Although there is no signatory list, signatures are known and queried when staff change. Signatories are also checked by Finance at the payment stage. In practice the risk is therefore negligible, but a signatory list will be created to highlight the importance of such checks.</p> <p>Responsible individual: Head of Grants</p> <p>Implementation date: September 2007</p>	<p>We found that authorised signatory lists are still not in use within the Grants Administration department. Management plan to take action to address this.</p> <p>Original recommendation has not yet been addressed.</p> <p>Responsible individual: Head of Grants</p> <p>Implementation date: November 2008</p>

Title	Original issue and recommendation	Original management response	Latest update position
<p>6.3.5</p> <p>Delays in preparing final accounts</p>	<p>The previous auditors raised concerns over the accounts preparation process and recommended that SAC reviews the overall resourcing and planning of the accounts.</p>	<p>The original management response attributed the delay in the accounts preparation process to the delays with the subsidiary accounts.</p> <p>Responsible individual: Finance Director</p> <p>Implementation date: 30 June 2007</p>	<p>We are pleased to report that the draft 2007/08 annual accounts were of a higher quality. However, further improvements can be made and management plan to review the process in time for the preparation of the 2008/09 annual accounts.</p> <p><i>We will follow this recommendation up during our 2008/09 audit.</i></p> <p>Responsible individual: Finance Director</p> <p>Implementation date: 30 June 2008</p>
<p>6.3.6</p> <p>Accounting arrangements relating to the administration of Lottery funds</p>	<p>The previous auditors recommended that SAC give consideration to simplifying treatment of re-charge costs.</p>	<p>Consideration will be given to the workload involved and the benefit of the additional information provided.</p> <p>Responsible individual: Finance Director</p> <p>Implementation date: 30 April 2007</p>	<p>The management accounting tools rely on this structure. The proposed change cannot be implemented until sufficient time is found to revise the reporting tools as well.</p> <p><i>Management has considered this recommendation and have chosen not to implement at present. No further action required.</i></p>



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