

INDEPENDENT AUDITOR'S REPORT TO THE TRUSTEES OF THE ARTS COUNCIL ENGLAND

I have audited the financial statements of the Arts Council England for the year ended 31 March 2011. These comprise the Statement of Financial Activities, the Balance Sheet, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (United Kingdom Generally Accepted Accounting Practice). I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Trustees, Chief Executive and auditor

As explained more fully in the Statement of Trustees' and Chief Executive's Responsibilities, the Trustees and Chief Executive, as Accounting Officer, are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

My responsibility is to audit and express an opinion on the financial statements in accordance with relevant legal and regulatory requirements. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Arts Council England's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Trustees and Chief Executive; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Review to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

In addition, I am required to obtain evidence sufficient to give reasonable assurance that the incoming and outgoing resources have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Opinion on Regularity

In my opinion, in all material respects, the incoming and outgoing resources have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Basis for Qualified Opinion on Financial Statements

Qualification arising from Lottery Commitments being met from Grant-in-Aid Moneys.

In forming the audit opinion I am required to consider whether, in all material respects, the expenditure recorded in the financial statements is relevant to those financial statements.

During 2010-11 grants of £9.2 million were paid from Grant-in-Aid money in respect of amounts previously recorded as Lottery commitments. This expenditure is recorded in these Grant-in-Aid financial statements and not in the Lottery financial statements. Once a hard commitment has been recorded within the Arts Council England's internal systems as a Lottery commitment the expectation is that its discharge should be recognised in the Lottery distribution accounts.

I consider that where grants have previously been accounted for as commitments of the Lottery and reported as such to Parliament, continuing grant payments should, except in exceptional circumstances, have been charged to the Lottery and not Grant-in-Aid. As a result, Grant-in-Aid expenditure has been materially overstated by £9.2 million in the 2010-11 Grant-in-Aid financial statements.

Qualified Opinion on Financial Statements

In my opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph:

- the financial statements give a true and fair view of the state of the Arts Council England's affairs as at 31 March 2011 and of the incoming resources and application of resources for

the year then ended;

- the financial statements have been properly prepared in accordance with the direction made by the Secretary of State under the Royal Charter.

Opinion on other matters:

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with in accordance with the direction made by the Secretary of State under the Royal Charter; and
- the information given in the Trustees' Report and Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records; or
- I have not received all of the information and explanations I require for my audit; or
- the Statement on Internal Control does not reflect compliance with HM Treasury's guidance.

My Report on pages 126 to 127 includes more details of the matters giving rise to my qualified opinion on the financial statements.

Amyas C E Morse

Comptroller and Auditor General

National Audit Office

157-197 Buckingham Palace Road

London SW1W 9SP

24 April 2012

THE CERTIFICATE OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSES OF PARLIAMENT

I certify that I have audited the financial statements of Arts Council England's Lottery distribution accounts for the year ended 31 March 2011 under the National Lottery etc. Act 1993. These comprise the Statement of Comprehensive Net Expenditure, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Equity and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of Trustees, Chief Executive and auditor

As explained more fully in the Statement of Trustees' and Chief Executive's responsibilities, the Trustees and Chief Executive, as accounting officer, are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the National Lottery etc. Act 1993. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the Audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Arts Council England's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Arts Council England; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the annual review to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

In addition, I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Opinion on Regularity

In my opinion, in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Basis for Qualified Opinion

Qualification arising from Lottery Commitments being met from Grant-in-Aid Moneys

In forming the audit opinion I am required to consider whether, in all material respects, all expenditure relevant to the financial statements has been included.

During 2010-11 grants of £9.2 million were paid from Grant-in-Aid money in respect of amounts previously recorded as Lottery commitments. This expenditure is included in the Grant-in-Aid financial statements and not in the Lottery financial statements. Once a hard commitment has been recorded within the Arts Council England's internal systems as a Lottery commitment the expectation is that its discharge should be recognised in the Lottery financial statements.

I consider that where grants have previously been accounted for as commitments of the Lottery and reported as such to Parliament, continuing grant payments should, except in exceptional circumstances, have been charged to the Lottery and not Grant-in-Aid. As a result, Lottery expenditure has been materially understated by £9.2 million in the 2010-11 Lottery financial statements.

Qualified Opinion on financial statements

In my opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph:

- the financial statements give a true and fair view of the state of Arts Council England's Lottery distribution accounts' affairs as at 31 March 2011 and of its net income for the year then

ended; and

- the financial statements have been properly prepared in accordance with the National Lottery etc. Act 1993 and Secretary of State directions issued thereunder.

Opinion on other matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with the Secretary of State directions issued under the National Lottery etc. Act 1993; and
- the information given in management commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records; or
- I have not received all of the information and explanations I require for my audit; or
- the Statement on Internal Control does not reflect compliance with HM Treasury's guidance.

Report

My Report on pages 126 to 127 includes more details of the matters giving rise to my qualified opinion on the financial statements.

Amyas C E Morse

Comptroller and Auditor General

National Audit Office

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24 April 2012

THE REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSES OF PARLIAMENT AND THE TRUSTEES OF THE ARTS COUNCIL ENGLAND

1. This report relates to my examination of the Arts Council England's Grant-in-Aid financial statements and Lottery financial statements for 2010-11 and summarises the basis on which I have issued a qualified audit opinion on each set of financial statements.

Background

2. The Arts Council England (the Council) was established by Royal Charter in 1994 and receives funding from two primary sources: the Department for Culture, Media and Sport (the Department) who provide an annual Grant-in-Aid allocation which in 2010-11 amounted to £435 million, and the National Lottery Distribution Fund which holds National Lottery income on behalf of the Council until required to make payments of Lottery Grants (income £179 million in 2010-11).
3. Since the inception of the Lottery there has been a clear separation between Grant-in-Aid funded activities and Lottery activities. In accordance with statutory provisions, separate annual financial statements are prepared by the Council and audited by the Comptroller and Auditor General.
4. In accordance with the provisions of HM Treasury's Managing Public Money, the Department have agreed with the Council a framework document and funding agreement relating to the provision of Grant-in-Aid. The Department have also issued directions to the Council, under the Lottery statutes, regarding the management and reporting of grants funded out of the Lottery.
5. If Grant-in-Aid funds are not utilised in the year to which they relate, the funds are returnable to the Exchequer, unless the Department give approval for the balance to be carried forward. The drawdown of Lottery funds is not subject to similar controls, and restrictions on carry forward do not apply. The Council therefore have greater flexibility in the timing of the use of Lottery Funds than Grant-in-Aid funds. The Council were concerned that arts organisation might lack financial resilience. Responding to this risk the Council established a £5 million contingency fund within Grant-in-Aid, available to provide emergency funding in 2010-11 to organisations in financial distress.
6. From October 2010 onwards the Council's Chief Operating Officer met with the Executive Director of Resources, Director of Investment and Director of Finance to consider the possible demands on the contingency and any unutilised Grant-in-Aid budget. At the end of the third quarter, the group decided that the Grant-in-Aid contingency was no longer needed. In addition the Council had realised savings of £4.2 million in administrative costs. This meant that the Council had some £9.2 million which could be used as direct support to the Arts Sector.
7. The Council determined to use the available £9.2 million of Grant-in-Aid money to meet 38 grant instalments to 34 organisations due under the Lottery between January 2011 and the year end. Previous payments on these projects had been paid from Lottery funds and accounted for in Lottery financial statements. The payments did not affect the total level of grant to the recipient arts organisations: it only represented a change in the source of that funding. The Council considered this was the best way to maximise both the utilisation of Grant-in-Aid and the funds available within the Lottery. The transactions have been disclosed in the Grant-in-Aid accounts and the Lottery accounts.
8. The Council told the National Audit Office that it had taken legal advice which confirmed that these were projects of the type which could be funded under the Royal Charter. The projects aims were consistent with the objectives of the Grant-in-Aid agreement with the Department and did not breach Grant-in-Aid conditions. However, the Council did not have a standard procedure for making such transfers, and action is being taken to obtain National Council's approval for such a process. In the case of the 38 payments, they each formed part of the discharge of a hard commitment which had been recorded by the Council in the Lottery financial statements in previous years, and reported to Parliament in the Council's Annual Review. The audit confirmed that these payments met the total outstanding commitments for these grants and there were no duplicate payments.

9. When the 38 transactions came to the attention of the audit team, the Council referred the matter to the Department. The Department, after consultation with HM Treasury, concluded that the payments were not inherently novel or contentious, and therefore did not require the approval of the Department and HM Treasury. The Department also confirmed that Grant-in-Aid funds must be kept entirely separate from the Lottery and that Grant-in-Aid funds cannot be paid over to supplement the lottery balance.

Audit Conclusion: Accounting Arrangements

10. In forming the audit opinion I am required to consider whether, in all material respects, the expenditure recorded in the financial statements is relevant to those financial statements. During 2010-11 grants of £9.2 million were paid from Grant-in-Aid money in respect of amounts previously recorded as Lottery commitments. This expenditure is recorded in these Grant-in-Aid financial statements and not in the Lottery financial statements. Once a hard commitment has been recorded within the Council's internal systems as a Lottery commitment the expectation is that its discharge should be recognised in the Lottery distribution accounts. Not meeting grant payments previously recorded as Lottery commitments out of Lottery moneys undermines the separateness of Grant-in-Aid and Lottery financial statements.
11. I consider that where grants have previously been accounted for as commitments of the Lottery and reported as such to Parliament, continuing grant payments should, except in exceptional circumstances, have been charged to the Lottery and not Grant-in-Aid. As a result, Lottery expenditure has been materially understated by £9.2 million in the 2010-11 Lottery financial statements, and Grant-in-Aid expenditure materially overstated by the same amount in the Grant-in-Aid financial statements. I have qualified my audit opinions accordingly.

Regularity of Expenditure

12. In the circumstances described in paragraph 11 above, I seriously considered qualifying my regularity opinion. However, I have concluded that I cannot do so given the lack of clarity in the guidance provided by the Department and HM Treasury. The Department and HM Treasury should consider clarifying their guidance on the use of Grant-in-Aid funding to meet lottery commitments, and they have recognised the need to do so.

Amyas C E Morse

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24 April 2012