

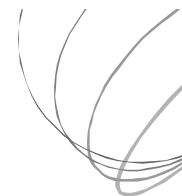
# National Galleries of Scotland

**Report on the 2006/07 Audit**



# Contents

<b>Executive Summary</b>	<b>2</b>	<b>Performance</b>	<b>8</b>
<b>Introduction</b>	<b>4</b>	<b>Governance</b>	<b>9</b>
<b>Financial Statements</b>	<b>5</b>	<b>Looking Forward</b>	<b>10</b>



# Executive Summary

## Introduction

In 2006/07 we audited the financial statements of the National Galleries of Scotland (NGS) 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 NGS for 2006/07.

The new FReM requirement to account for grant-in-aid as a credit to reserves has resulted in an excess of expenditure over income of £9.847 million for 2006/07 (2005/06 restated: £8.834 million). The grant-in-aid credited to reserves for 2006/07 was £11.165 million (2005/06: £10.944 million).

NGS operated within the budget limits set by the Scottish Executive for capital spending and operating expenditure.

## Performance

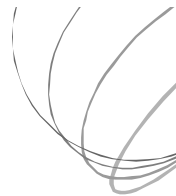
NGS undertook a strategic review during the year which resulted in revised corporate objectives being set for the period 2007/2010. A number of key areas have been prioritised including education. NGS reported a number of performance indicators in the annual accounts for the year ended 31 March 2007 and these included attracting over 1.5 million visitors to the sites which was a record number.

## 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 NGS operated satisfactorily during the year, as reflected in the Statement on Internal Control.

## Looking Forward

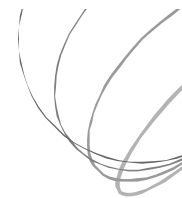
Capital charges comprising depreciation and cost of capital make up some 19% of NGS's initial financial allocation in 2007/08, and are likely to remain a significant item in NGS accounts for the foreseeable future. They are a non-cash revenue budget allocation at present but this is under review by the Scottish Government. The basis and quantification of the charge is largely uncontrollable and NGS will need to monitor the position closely to ensure that it does not reduce budget provision in other activity areas



As part of the 2007/08 audit we will be reviewing the progress that NGS has made in strengthening its arrangements for securing Best Value since the baseline review work in 2005/06.

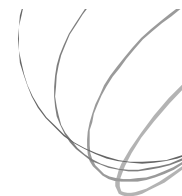
Audit Scotland, on behalf of the Auditor General, is carrying out a value for money review of 20 major capital projects across the public sector in Scotland and one of these projects is the NGS Playfair project. We will review the recommendations made in that report as part of our 2007/08 audit.

**Audit Scotland**  
**November 2007**



# Introduction

1. This report summarises the findings from our 2006/07 audit of NGS. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 28 February 2007. This plan described the work we planned to carry out on financial statements, performance and governance.
2. This is the first 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 NGS during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).



# Financial Statements

3. In this section we summarise key outcomes from our audit of NGS's financial statements for 2006/07, and comment on the key financial management and accounting issues faced.

## Our Responsibilities

4. We audit the financial statements and give an opinion on:
  - whether they give a true and fair view of the financial position of NGS and its expenditure and income for the period in question
  - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements, and
  - the regularity of the expenditure and receipts.
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 NGS.

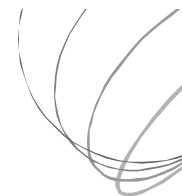
## Overall Conclusion

6. We have given an unqualified opinion on the financial statements of NGS for 2006/07.

## Financial Position

### 2006/07 outturn

7. The new FReM requirement to account for grant-in-aid as a credit to reserves has resulted in an excess of expenditure over income of £9.847 million for 2006/07 (2005/06 restated: £8.834 million). The grant-in-aid credited to reserves for 2006/07 was £11.165 million (2005/06: £10.944 million).
8. NGS's net asset position increased to £139.134 million (2005/06: £113.495 million).
9. A purchase grant of £1.26 million was allocated to NGS for 2006/07 (2005/06: £1.26 million) to add to the collections. The value of artworks purchased by NGS during the year was £1.977 million (2005/06: £1.507 million).



10. NGS operated within the budget limits set by the Scottish Executive for capital and operating expenditure.

## 2007/08 budget

11. Scottish Ministers have set an initial financial allocation for NGS of £15.739 million for 2007/08. This comprises:
  - £11.465 million grant-in-aid which is an increase of £0.3 million compared to 2006/07
  - a purchase grant of £1.26 million which is the same as 2006/07, and
  - £3.014 million to cover non-cash costs.
12. NGS has attained greater stability after two years of difficult financial management however funding remains tight. In 2007/08 NGS are focusing on spending priorities while still delivering a high quality visitor service.

## Issues Arising from the Audit

13. We reported the following issues to the Audit Committee members.
14. **Financial statements disclosures** – During the course of the audit we made a number of suggestions to update or improve the financial statement disclosures, in line with FReM requirements, which NGS has accepted and implemented. With changes in FReM planned to reflect international financial reporting standards we have agreed to work with NGS to support enhanced disclosures and presentation in the 2007/08 financial statements.
15. **Fixed assets including donated assets** – FReM requires that any revaluations of a donated asset should be charged to a Donated Assets Reserve rather than a Revaluation Reserve – which is specifically for purchased assets. As NGS is unable to separately identify revaluations relating to donated assets, all 2006/07 revaluations were reflected through the Revaluation Reserve. Current disclosures are not in accordance with the requirements of FReM. Fixed assets records are kept on Excel spreadsheets which do not readily provide the required information for financial statements disclosures. NGS has agreed to review fixed assets and a fixed asset accounting package has been recently installed which should provide better information for 2007/08 account disclosures.
16. **Internal Control assurances** – Although the Scottish Public Finance Manual requires all public bodies to operate a cascaded Certificate of Assurance approach to support assertions made in Statements on Internal Control, NGS does not. NGS does conduct a review to support the Statement on Internal Control, but this is not formalised and documented per the requirements of the Manual. Certificates of assurance are now a standard part of corporate governance regimes in the public sector, and are normally completed by the Senior Management Team or equivalent in order to



improve accountability and provide assurance to the Accountable Officer on specific aspects within their area of responsibility, including the management of risk, the maintenance of effective systems of internal control and compliance with relevant policies and legal provisions. NGS has confirmed that the introduction of a new financial system and related control procedures offers the opportunity to introduce a more formalised system in accordance with the Scottish Executive guidance on Statements on Internal Control.

17. **Unadjusted errors** - Several errors were identified during the audit, where if adjustments were made these would have a net effect of decreasing by £30,197 the excess of expenditure over income for the year shown in the income and expenditure account. The net impact on the balance sheet would be that net assets would increase by £30,197. As these errors are immaterial to the accounts as a whole, officers in finance did not adjust the accounts for these errors and we agreed with this.

## Statement on Internal Control

18. The Statement on Internal Control (SIC) provided by NGS's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and it set out NGS's approach to this.

## Regularity Assertion

19. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts was incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.



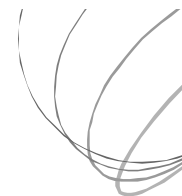


# Performance

20. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
21. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

## Performance

22. NGS undertook a strategic review during 2006/07 which resulted in revised corporate objectives being set for the period 2007/2010. A number of key areas have been prioritised including education. Performance against key priorities and objectives is monitored. NGS reported a number of performance indicators in the annual accounts for the year ended 31 March 2007 and these included attracting 1.5 million visitors to the sites which was a record number.



# Governance

## Overview of Arrangements

23. This section sets out our main findings arising from our review of NGS governance arrangements.

This year we reviewed:

- key systems of internal control, and
- internal audit.

24. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position (see paragraphs 7-12). Our overall conclusion is that arrangements within NGS are sound and have operated throughout 2006/07.

## Systems of Internal Control

25. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In their annual report for 2006/07 Baker Tilly, the internal auditors, provided their opinion that, based on the internal audit work undertaken during the year and improvements undertaken following their reports, there was an adequate framework of control over the systems examined. The SIC refers to internal audit reviews and actions being taken to address the issues raised.

26. As part of our audit we reviewed the high level controls in a number of NGS systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively.

## Internal Audit

27. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2006/07 audit we assessed whether we could place reliance on the internal audit service provided by Baker Tilly. We concluded that the internal audit service operates in accordance with the Government Internal Audit Manual and therefore placed reliance on a number of internal audit reviews.

# Looking Forward

28. NGS faces a number of challenges in 2007/08, which include:

- **Capital charges** - Depreciation and the cost of capital make up some 19% of NGS's initial financial allocation in 2007/08, and are likely to remain a significant item in NGS accounts for the foreseeable future. They are a non-cash revenue budget allocation at present but this is under review by the Scottish Government. The basis and quantification of the charge is largely uncontrollable, and NGS will need to monitor the position closely to ensure that it does not reduce budget provision in other activity areas.
- **Best value** – As part of the 2007/08 audit we will be reviewing the progress that NGS has made in strengthening their arrangements for securing Best Value since the baseline review work in 2005/06. Over the next year we will also be developing and refining our approach to the audit of public bodies' arrangements to secure economy, efficiency and effectiveness in the use of resources, as this is one of our key objectives as auditors, set out within the new Code of Audit Practice approved by the Auditor General. This will inform our ongoing work to develop an approach to the audit of Best Value across the Scottish public sector. We intend to consult with both clients and stakeholders at key stages of these initiatives.
- **Review of major capital projects** - Audit Scotland, on behalf of the Auditor General, is carrying out a value for money review of 20 major capital projects across the public sector in Scotland. One of these projects is the NGS Playfair project. The work will focus on arrangements for planning, managing and delivering them within cost and timetable and will culminate in a report to the Audit Committee of the Scottish Parliament. We will review the recommendations made in that report as part of the 2007/08 audit.
- **International Financial Reporting Standards** – The introduction of IFRS's from 2008/09 is likely to significantly change some accounting policies. NGS will need to review their accounting policies to ensure that appropriate disclosures are made in the financial statements.
- **Efficient government** – The achievement of future Efficient Government targets represents a huge challenge for NGS. Over the last few years NGS have reduced expenditure and they recognise that it will be difficult to make further savings over the next three years without reducing services.
- **Whole of Government Accounts (WGA) and faster closing agenda** – The timetable for the completion of audited accounts for all public sector bodies is being brought forward in stages to facilitate the completion of a WGA for the UK public sector. The overall project is managed by HM Treasury, with the Scottish Executive co-ordinating the process in Scotland. NGS will need

to maintain close liaison with staff in the Scottish Executive on timetabling and related resourcing issues arising from this project.

- **Impending changes in the valuation of heritage assets** – In December 2006 the Accounting Standards Board issued an exposure draft (ED 40 – Accounting for heritage assets) proposing changes in the valuation and recognition arrangements for heritage assets. There has been a mixed response to the ED, and it is not clear that any resulting Financial Reporting Standard (FRS) will reflect in full the ED proposals. Nevertheless, any changes in the accounting and disclosure requirements are likely to be adopted by the FReM and will therefore be applicable to NGS. Given the extent of heritage assets owned by NGS, it is important that developments in this area are monitored closely by NGS Finance Department.