

National Galleries of Scotland

Report on the 2008/09 audit

November 2009

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AUDIT SCOTLAND

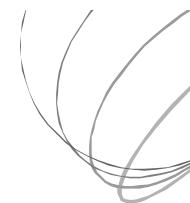
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Key messages

In 2008/09 we looked at the key strategic and financial risks being faced by National Galleries of Scotland (NGS). We audited the financial statements and we also reviewed the use of resources and aspects of performance management and governance. This report sets out our key findings.

Financial statements

We have given an unqualified opinion on the financial statements of NGS for 2008/09. We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance issued by Scottish Ministers.

Financial position and use of resources

NGS operated within the budget limits set by the Scottish Government for capital spending and operating expenditure. NGS' net asset position increased to £267.897 million (2007/08: £159.038 million) mainly due to acquisition of the Artist Rooms collection and Titian's *Diana and Actaeon*.

Scottish Ministers have agreed a financial allocation for NGS of £23.731 million for 2009/10. This comprises operating expenditure of £12.426 million, capital expenditure of £8.291 million and non-cash costs of £3.014 million.

NGS is required by the Scottish Government to deliver efficiency savings of three per cent for each of 2009/10 and 2010/11. This represents £0.7 million by 2010/11 which is a considerable sum in proportion to NGS' non-salary cost base. The delivery of these efficiency savings together with other budget pressures in the medium term is a significant challenge for NGS.

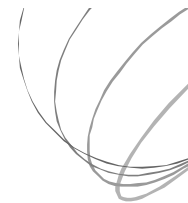
Governance and accountability

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.

We examined the key financial systems which underpin the organisation's control environment. We concluded that financial systems and procedures operated sufficiently well to enable us to place reliance on them.

Performance

NGS set performance targets for 2008/09 in a number of areas. NGS reported that the target for visitors to the Edinburgh galleries was missed by four per cent reflecting the difficult economic climate which



adversely affected tourism but virtual visits to the website exceeded target by 25%. Other targets for education and outreach programmes were exceeded by ten per cent.

NGS has drafted its corporate plan for 2009 – 2011. The plan is being revised to reflect the new way of working with continual input from Scottish Government. The next stage will be completed by the end of October 2009 at which time the high level objectives will be published on the website. NGS' three key priorities are:

- to increase access, encourage participation and promote learning
- to encourage artistic excellence, innovation and creativity
- to develop a sustainable and efficient business model to support NGS' aims and ensure long-term viability.

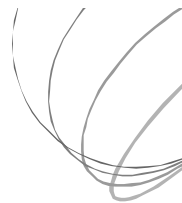
These priorities are aligned with wider Scottish Government policies and strategies and Scottish Government National Outcomes. NGS has set objectives, actions designed to achieve objectives and performance measures and targets. The delivery of the corporate plan objectives will be particularly challenging given the tight financial constraints over the same period.

Looking forward

The final part of our report notes some key risk areas and issues for NGS going forward. NGS faces significant financial pressure over the next two years to achieve financial balance. Effective budget monitoring and reporting arrangements will be crucial to NGS achieving its financial targets within tighter funding settlements. We will continue to monitor financial planning arrangements and NGS' financial position. We highlighted a number of national issues which affect all public sector bodies including NGS: the National Performance Framework and the introduction of Scotland Performs; and the review of data handling arrangement in public bodies across Scotland.

The assistance and co-operation given to us by staff and Board members during our audit is gratefully acknowledged.

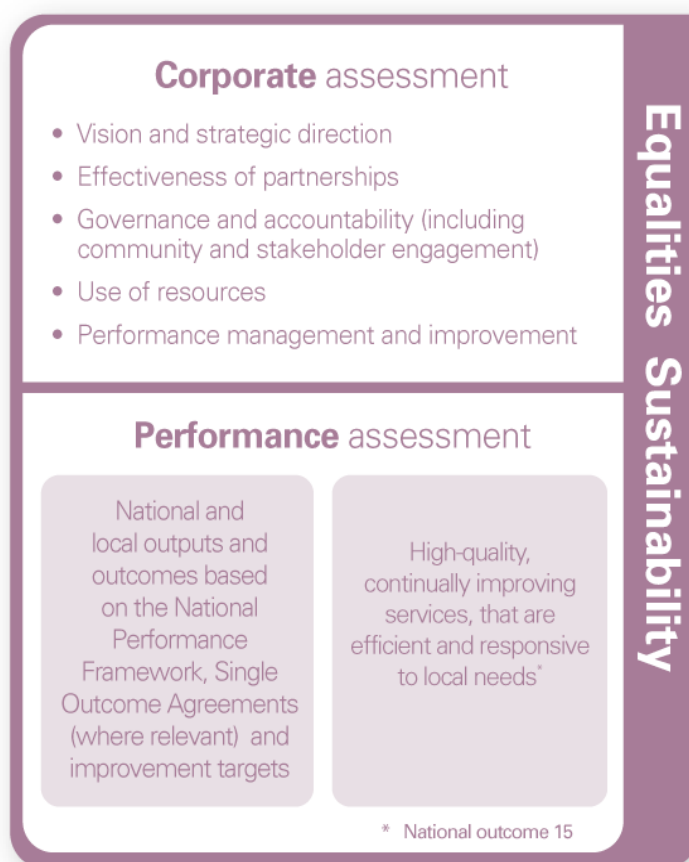
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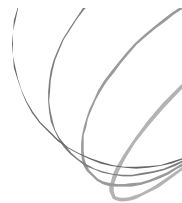


Introduction

1. This report summarises the findings from our 2008/09 audit of NGS. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 9 March 2009. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued one report this year, and we briefly touch on the key issues we raised in this report. The report set out our detailed findings and recommendations and the Board's agreed response.
3. Best value duties apply across the public sector and, in central government, best value is a formal duty on all accountable officers. Audit Scotland has adopted a generic framework for the audit of best value across the public sector and throughout this report we comment on aspects of NGS' arrangements.

Exhibit 1: Framework for a best value audit of a public body

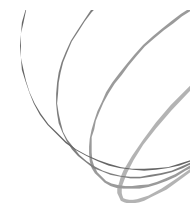




4. Our comments are made on the basis of information made available in the course of the annual audit. We do not make an overall best value judgement because we do not have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time. This report is the first step towards that goal.

5. Another building block for our assessment of best value is the national study programme carried out by Audit Scotland on behalf of both the Auditor General for Scotland and the Accounts Commission. We mention the key findings from all relevant reports, and the implications for NGS throughout this report. Full copies of the study reports can be obtained from Audit Scotland's website, www.audit-scotland.gov.uk.

6. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by staff and Board 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.



Financial Statements

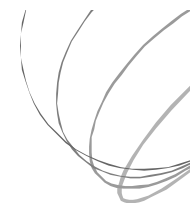
7. In this section we summarise key outcomes from our audit of NGS financial statements for 2008/09 and the accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

8. 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 were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements;
 - the consistency of the information which comprises the Report of the Trustees within the financial statements;
 - the regularity of the expenditure and receipts.
9. We also review the statement on internal control by:
 - considering the adequacy of the process put in place by the Director-General as Accountable Officer to obtain assurances on systems of internal control;
 - assessing whether disclosures in the statement are consistent with our knowledge of NGS.

Overall conclusion

10. We have given an unqualified opinion on the financial statements of NGS for 2008/09.
11. The date agreed in the audit plan for submission of the unaudited accounts supported by a comprehensive working paper package was 13 July 2009. A working paper package was available on 13 July 2009 providing full analysis of the majority of the balance sheet. Draft accounts were provided on 17 July 2009 and a complete set of accounts was provided on 28 July 2009. Although the original deadline was missed the submission date achieved is a marked improvement on recent years. We concluded our audit within the agreed timetable and provided our opinion to the Audit Committee on 3 September 2009 as timetabled. NGS anticipate that the exceptional circumstances i.e. new system introduction and staff changes which affected this year end accounts production will not recur. A realistic timetable will be agreed between Audit Scotland and NGS Finance team in early 2010.



Issues arising from the audit

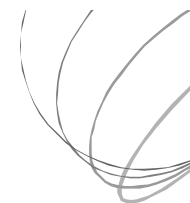
12. As required by auditing standards we reported to the audit committee on 3 September 2009 the main issues arising from our audit of the financial statements. The key issue was as follows:
13. **Operating a commercial bank account** – NGS operates a commercial bank account but had not yet obtained approval for this (a requirement of the Scottish Public Finance Manual (SPFM)) from the Scottish Government's Treasury and Banking Branch (T&BB). NGS has now received approval to continue operating its existing commercial bank accounts from T&BB.

Regularity

14. 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 were 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.

International financial reporting standards (IFRS)

15. As announced by the Chancellor in the 2008 Budget report on 12 March 2008 (Budget report paragraph C103), Government departments and other public sector bodies will report using International Financial Reporting Standards (IFRS) from 2009/10. The Scottish Government announced on 25 April 2008 that all Scottish Government Departments, Executive Agencies, Health Bodies and Non-Departmental Public Bodies would be required to produce shadow IFRS based accounts for financial year 2008/09. However, this timetable does not apply to registered charities, such as NGS, which will be required to follow a slower timetable for convergence agreed by the UK Accounting Standards Board. Notwithstanding the slower timetable applying to NGS, the convergence process may require significant resource to complete and it is important that the NGS properly plans to manage the transition over the next few years.



Use of Resources

16. Sound management and use of resources (people, money and assets) to deliver strategic objectives is a key feature of best value. This section sets out our main findings from a review of NGS' financial position and use of resources.

Financial Position

Outturn 2008/09

17. NGS is required to work within the budget limits set by the Scottish Government. The total financial allocation set by the Scottish Government for NGS for 2008/09 was £25.561 million. This figure comprises an operating budget of £12.213 million, capital budgets of £8.759 million, and non-cash items of £4.589 million. NGS operated within the budget limits set by the Scottish Government for capital and operating expenditure and drew down its full cash grant in aid entitlement.
18. The FReM requirement to account for grant-in-aid as a credit to reserves has resulted in an excess of expenditure over income of £11.529 million for 2008/09 (2007/08: £10.337 million). The grant-in-aid credited to reserves for 2008/09 was £12.213 million (2007/08: £11.465 million).
19. NGS operated within the financial allocations set by the Scottish Government for cash expenditure and non cash costs – see exhibit 2 below:

Exhibit 2 – Performance against resource budget 2008/09

Cash Items			
Operating costs	12.213	12.213	Nil
Purchase grant	1.260	1.260	Nil
Major projects	7.499	7.499	Nil
Non cash items			
Cost of capital	3.594	3.586	-0.008
Depreciation	0.995	1.002	0.007

20. NGS' balance sheet at 31 March 2009 shows net assets of £267.897 million (2008/09 net assets of £159.038 million). The increase is mainly caused by the acquisition of the Artist Rooms collection and Titian's *Diana and Actaeon*. Capitalised gallery collection items are valued at cost or value of the



acquisition. Where the acquisition is part donation, part purchase the asset is capitalised at current value on receipt.

Financial sustainability and the 2009/10 budget

21. Scottish Ministers have agreed a financial allocation for NGS of £23.731 million for 2009/10. This comprises operating expenditure of £12.426 million, capital expenditure of £8.291 million and non-cash costs of £3.014 million.
22. This is to be funded as follows:

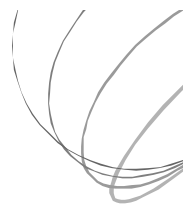
Exhibit 3 – 2009/10 Resource Plan

Cash Items	
Operating costs	12.426
Purchase grant	1.260
Major projects	7.031
Non cash items	
Cost of capital	1.794
Depreciation	1.220

23. NGS is expected to achieve efficiency savings of three per cent per year for each of 2009/10 and 2010/11 and grant in aid will not be uplifted for pay or general inflation as this is expected to be met from NGS' efficiency savings each year. NGS has forecast a balanced budget for 2009/10 and 2010/11. Delivering efficiencies year on year while absorbing pay inflation and other cost pressures represents a significant challenge for the organisation.
24. NGS receives specific funding for larger capital projects from the Scottish Government and from various other donors including the National Heritage Memorial Fund, the Art Fund and private individuals. Major projects funding from Scottish Government for 2009/10 is mainly phased payment for Titian's *Diana and Actaeon* and for the refurbishment of the Scottish National Portrait Gallery.

National Studies

25. Audit Scotland published three national studies relevant to NGS' use of resources. These were use of consultancy services, improving energy efficiency and improving public sector purchasing.



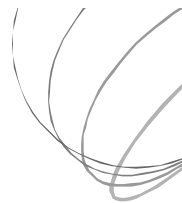
Use of consultancy services

26. The overall aim of the study was to review central government's use of consultancy services and to make recommendations to improve the public sector's use of consultants' knowledge, skills and resources to help deliver new services and initiatives quickly and expertly. The key findings were as follows:

- The public sector is strengthening the way it buys goods and services.
- Central government does not have a clear strategy for its use of consultants or for linking use to its priorities or financial and workforce plans.
- In most cases, central government buys consultancy services well but some improvements can be made.
- Central government could improve how it manages consultancy projects through more consistent and formal evaluation of consultants' work and learning more from them.
- Central government could make savings of up to £13 million a year through better planning and buying of consultancy services.

27. The report made specific recommendations for public bodies:

- confirm they have clear processes for approving and recording the use of consultants and monitoring progress, and reinforce these as required
- plan their use of consultancy services when developing their forward work programme to ensure that consultants are used where their knowledge and skills bring greatest value for money
- always evaluate the option to use consultants against the option to use their own staff
- gather and share consistent information on the consultancy skills bought and why consultants are used
- improve the quality of their invitations to tender through better and earlier discussion with consultants about their consultancy needs
- increase the use of framework agreements where possible by ensuring that existing agreements are used and new ones developed as appropriate
- select and use the most economical competition routes by using framework agreements, restricted competitions and closed tendering approaches when appropriate
- evaluate the work of consultants more systematically and share findings from these reviews



- work closely with consultants to increase assurance on quality and make use of opportunities to learn from consultants and ensure knowledge transfer, where appropriate.

28. NGS does not contribute spending data to the Scottish Government Information Procurement hub and was not one of the case studies. NGS will keep abreast of best practice.

Improving energy efficiency

29. Audit Scotland assessed how councils, NHS bodies and central government bodies were improving energy efficiency in relation to buildings and transport use. This included examination of a range of issues including whether public bodies demonstrate commitment to improving energy efficiency; how public bodies are performing against their objectives and targets for improving energy efficiency; and if public bodies are delivering continuous improvement in this area.

- Funding has been made available by the Scottish Government and public bodies to improve energy efficiency. While energy consumption in buildings has fallen, spending on energy increased in the three years to 2006/07.
- There is a need for stronger leadership by the Scottish Government and within public bodies to improve energy efficiency and ensure that the necessary cultural and behavioural changes are made.
- A robust strategy is central to the coordination of activities to improve energy efficiency, however, there are inconsistencies in the quality of strategies being implemented.
- There is a lack of formal monitoring and reporting of progress in improving energy efficiency by public bodies and the Scottish Government.

30. NGS completed the survey which Audit Scotland issued to councils, NHS bodies and central government bodies. NGS will implement a performance target on carbon emissions for 2009/10 in line with the National Performance Framework.

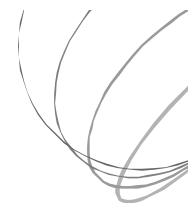
Improving public sector purchasing

31. Audit Scotland assessed the impact of the Public Procurement Reform Programme (the Programme) which aimed at improving purchasing practice and making savings of about three per cent a year. This included examination of the savings from the Programme and the wider benefits of the Programme. The report noted the following:

- The Programme which is ambitious and challenging has made significant progress but some changes are taking longer than planned to implement and performance measures are largely incomplete.



- Around £327 million has been saved in the first two years of the Programme which is in line with the Programme target however some savings have been delayed and because of limited data it is unclear how progress towards the third year target of £400 million will be monitored.
 - Overall the impact of the Programme appears positive however the scale of improvement is difficult to quantify and there are variable levels of engagement by public bodies.
 - Key risks to the Programme include maintaining momentum, programme management, availability of information and shortages of skilled staff. These need to be addressed to help accelerate the Programme.
32. NGS collaborates where possible with the Scottish Procurement Directorate (SPD) on appropriate procurement projects to avoid duplication of purchasing effort and routes requirements for generic goods and services through the Scottish Government framework agreements and collaborative contracts where these are advantageous. NGS also collaborates directly with others in the public sector (for example, National Library of Scotland, National Museums of Scotland and Royal Botanic Garden Edinburgh) over the purchase of goods and services which are specific to its needs.



Governance and Accountability

33. High standards of governance and accountability, with effective structures and processes to govern decision-making and balanced reporting of performance to the public, are fundamental features of best value. This section sets out our findings arising from a review of NGS arrangements.
34. Increasingly services are being delivered across the public sector through partnership working, sometimes involving complex governance and accountability arrangements. Best value characteristics also include effective partnership working to deliver sustained improvements in outcomes.

Overview of arrangements

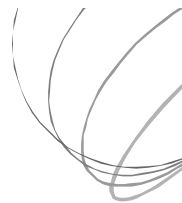
35. This year we reviewed:
 - partnership working
 - key systems of internal control
 - internal audit
 - arrangements for the prevention and detection of fraud and irregularity, including standards of conduct.
36. Our overall conclusion is that arrangements within NGS are sound and have operated through 2008/09.

Partnership working

37. In January 2008, the First Minister issued a statement on *More Effective Government*. It outlined his vision for simplifying the public sector and delivering a reduction in the number of public sector organisations. NGS has been working with National Museums Scotland and the National Library of Scotland to develop and implement a shared services programme for the National Collections organisations, with the aim of making best use of resources and working more closely together. The three bodies agreed a joint workplan for five areas of common working which merit further exploration. We will monitor developments.

Systems of internal control

38. 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 2008/09



Baker Tilly, the internal auditors, provided their opinion that based on the internal audit work undertaken during the year, NGS has an adequate framework of control over the systems examined.

39. As part of our audit we reviewed the high level controls in a number of NGS systems that impact on the financial statements. This audit work covered a number of areas including accounts payable and receivable. Our overall conclusion was that key controls were operating effectively and that NGS has adequate systems of internal control in place. We did identify a number of minor areas where controls could be strengthened and agreed an action plan of improvements with management. This will be followed up in 2009.

Statement on Internal Control

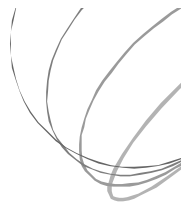
40. The Statement on Internal Control provided by NGS Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out NGS' approach to this. The Statement on Internal Control drew attention to improvements in management information resulting from the implementation of new finance and e-procurement systems; implementation of actions highlighted in the 2007/08 reviews by internal audit of security and ICT; consideration of the implications of the Scottish Government Security Policy Framework; and strategies in place to meet financial commitments for various projects.

Internal Audit

41. 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 2008/09 audit we assessed whether we could place reliance on NGS internal audit function. We concluded that Baker Tilly operates in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in number of areas during 2008/09, as we anticipated in our annual audit plan.

Prevention and detection of fraud and irregularities

42. NGS has appropriate arrangements in place to prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and Board members.
43. There were no reported frauds in 2008/09.

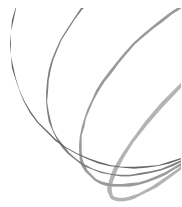


Performance

44. 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. Key features of best value include:
- setting a clear vision of what the organisation wants to achieve, backed up by plans and strategies to secure improvement, with resources aligned to support their delivery;
 - a performance management culture which is embedded throughout the organisation and a performance management framework which is comprehensive and supports the delivery of improved outcomes.
45. In this section we comment on:
- NGS corporate plan
 - performance against targets
 - risk management
 - efficiency.

Vision and strategic direction

46. NGS has drafted its corporate plan for 2009 – 2011. The plan is being revised to reflect the new way of working with continual input from Scottish Government. The next stage will be completed by the end of October 2009 at which time the high level objectives will be published on the website. The purpose of the NGS as set out in the governing legislation (the National Heritage (Scotland) Act 1985) is to:
- care for, preserve and add to the objects in the collections
 - ensure that the objects are exhibited to the public
 - ensure that the objects are available to persons seeking to inspect them in connection with study or research; and generally to promote the public's enjoyment and understanding of the Fine Arts
 - and for those purposes to provide education, instruction and advice and to carry out research.
47. NGS' three key priorities are:
- to increase access, encourage participation and promote learning
 - to encourage artistic excellence, innovation and creativity



- to develop a sustainable and efficient business model to support NGS' aims and ensure long-term viability.

48. These priorities are aligned with the wider policies and strategies established by Scottish Government. NGS aims to contribute to the following Scottish Government National Outcomes:

- we are better educated, more skilled and more successful, renowned for our research and innovation
- our young people are successful learners, confident individuals, effective contributors and responsible citizens.
- we take pride in a strong, fair and inclusive national identity
- we reduce the local and global environmental impact of our consumption and production
- our public services are high quality, continually improving, efficient and responsive to local people's needs.

49. Within each priority NGS has set objectives, actions designed to achieve objectives and performance measures and targets. The delivery of the corporate plan objectives will be particularly challenging given the tight financial constraints over the same period. This is an area we will keep under review.

Performance overview

50. NGS set performance targets for 2008/09 in a number of areas. Examples of reported achievements against targets include:

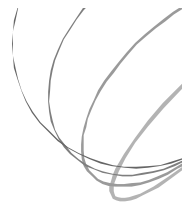
- Actual visitor numbers to Edinburgh galleries was four per cent less than the target. This reflected the difficult economic climate which adversely affected tourism. However virtual visits through the website were reported to be up by 25% against target.
- School visits to galleries, community and outreach participants and adult participants in talks, lectures and practical workshops exceeded targets in total by ten per cent.

51. Discussions are continuing with the Scottish Government on improvements in the ways that the performance of NGS can be assessed for 2009/10.

Risk management

52. NGS operates a risk management policy. Business risks are monitored at operational and senior management/Board level. Key risks identified by NGS at senior management/Board level include:

- change of policy by the Sutherland Trustees and other major lenders



- inability to establish sufficient funding to manage the Portrait Gallery running costs, potentially resulting in delaying the re-opening
- not responding to the need for change in the light of difficult economic circumstances
- high commitment on three major projects, resulting in potential liquidity crisis and loss of purchase grant in immediate future and limited funding for other activities.

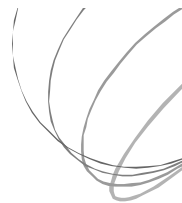
53. The NGS senior management team has put in place a series of control measures to manage these key business risks. These include effective management of the relationship with the Sutherland Trust and other lenders, continuing the Portrait Gallery fundraising campaign and close management and control of the Portrait Gallery project, carrying out a review of organisation and financial structure and adequate cashflow planning. The challenge for the Board and senior management team will be to embed a risk aware culture within the organisation for the future management of existing and emerging risks in the medium to long term.

Efficiency

54. In the current three year budget settlement NGS was required to make efficiency savings of nil per annum for 2008/09, and is required to make three per cent efficiency savings for each of 2009/10 and 2010/11. This represents £0.7 million by 2010/11 which is a considerable sum in proportion to NGS' non-salary cost base. This is a significant challenge.

55. To assist in balancing the budgets for 2009/10 and 2010/11, NGS has delayed some project spend and reduced departmental budgets. The closure of the Portrait Gallery also enables significant savings in running costs. NGS is working towards re-aligning spending with available resources to enable the re-opening of the Portrait Gallery on time.

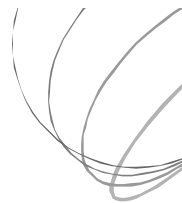
56. We will continue to monitor the financial position and the actions taken by NGS to manage the budget.



Looking Forward

57. NGS faces a number of challenges in 2009/10, which include:

- **Financial management and affordability** - The Scottish Parliament's Finance Committee recently published its report on the Scottish Government budget. The report noted that Scottish Government spending is set to decline in the next few years as UK public finances come under increasing pressure. Effective budget monitoring and reporting arrangements will be crucial to NGS achieving its financial targets within tighter funding settlements. We will consider NGS' financial management arrangements as part of our 2009/10 audit.
- **National Performance Framework** - The Scottish Government is continuing to develop its approach to performance management based on the National Performance Framework and local authority single outcome agreements. The National Performance Framework is an outcome-based approach that is publically reported on the Scottish Government's web site in the 'Virginia-style' model of performance measurement and reporting. This will include progress on overall delivery of the administration's purpose for Government, the five strategic objectives for Scotland and other aspects of the outcomes based National Performance Framework. We will consider how NGS is addressing this developing area as part of the 2009/10 audit.
- **Efficiencies and future funding** - Budgets for 2009/10 and the immediate future will need to be managed within a tighter funding regime. This includes no scope for the application of end of year flexibility for the Government with HM Treasury until the next Spending Review and no option to transfer funds from capital to revenue. NGS needs to find £0.7 million of savings over the next two years to achieve financial balance. The challenge for NGS is to prioritise spending, identify efficiencies and review future commitments to ensure delivery of key targets and objectives.
- **Data Handling** - The Scottish Government carried out a review of data handling arrangements in Scotland during 2007. The review considered current policies and procedures on data protection, consistency with government standards and local arrangements for implementation of procedures. A Scottish Government report published in June 2008 made recommendations for a higher level of oversight and guidance from the Scottish Government and improved security of sensitive information. NGS is considering the implementation of the Scottish Government Security Policy Framework. We will monitor NGS' progress against recommendations due to be implemented during 2009/10.
- **Heritage Assets** - The Accounting Standards Board Financial Reporting Standard 30 on heritage assets has significant new disclosure requirements for reporting the content and value



of heritage assets. Although the new standard is not mandatory until 2010/11 NGS will need to prepare for a significant impact on the accounts.

- **IFRS** - The timetable for IFRS implementation requires that central government accounts in Scotland become IFRS compliant with effect from the 2009/10 financial year. However implementation has been deferred for charities and, as yet, the date for shadow accounts has not been agreed. The processes to implement IFRS will require significant resource to complete and these issues should be addressed in 2009/10.