

National Museums Scotland: Consolidated Accounts

Report on the 2006/07 Audit



October 2007



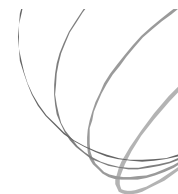
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Executive Summary

Introduction

In 2006/07 we audited the consolidated financial statements of the National Museums Scotland (NMS) 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 consolidated financial statements of NMS for 2006/07.

The new FReM requirement to account for grant-in-aid as a credit to reserves resulted in NMS reporting an excess of expenditure over income for the year of £18.880 million in 2006/07 (2005/06 results were restated to reflect the change in accounting policy, and show £17.901 million excess of expenditure). The grant-in-aid credited to reserves for the year was £23.737 million (2005/06: £23.538 million). NMS operated within the budget limits set by the Scottish Executive for capital expenditure and operating expenditure.

NMS's consolidated balance sheet at 31 March 2007 showed net assets of £166.587 million (2005/06: £162.777 million).

Performance

NMS was successful in achieving funding towards the cost of the refurbishment of the Royal Museum. They also continued to work towards objectives set by the Scottish Executive and increased visitor numbers both to the various museums and the website.

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

Internal Audit assurance on the effectiveness of internal control procedures was restricted to "adequate" because of the absence of any testing of NMS's disaster recovery procedures relating to computerised systems.

Looking forward

A major refurbishment of the Royal Museum is currently underway with a budgeted cost of £46.4 million. The delivery of the project will require good project planning, effective accounting arrangements and sound



arrangements for the storage and safe keeping of collections during the period of refurbishment. We will monitor progress on these matters during our 2007/08 audit.

Capital charges comprising depreciation and cost of capital totalling £6.676 million make up some 22% of NMS's operating budget of £30.064 million from the Scottish Government in 2007/08, and are likely to remain a significant item in NMS 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 NMS will need to monitor the position closely to ensure that it does not reduce budget provision in other activity areas.

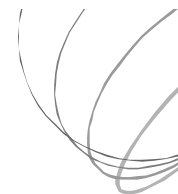
As part of the 2007/08 audit we will also be reviewing the progress that NMS has made in strengthening their arrangements for securing Best Value since our baseline review work in 2005/06.

Audit Scotland
October 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of NMS. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 16 March 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 NMS 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.



Financial Statements

3. In this section we summarise key outcomes from our audit of NMS 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 NMS 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
 - 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
 - assessing whether disclosures in the statement are consistent with our knowledge of NMS.

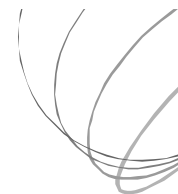
Overall conclusion

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

Financial position

2006/07 outturn

7. The new FReM requirement to account for grant-in-aid as a credit to reserves resulted in NMS reporting an excess of expenditure over income for the year of £18.880 million in 2006/07 (2005/06 results were restated to reflect the change in accounting policy, and show a £17.901 million excess of expenditure). The grant-in-aid (running costs, capital grants and purchase grant) credited to reserves for the year was £23.737 million (2005/06: £23.538 million). NMS operated within the budget limits set by the Scottish Executive for capital and operating expenditure.
8. NMS's balance sheet at 31 March 2007 showed net assets of £166.587 million (2005/06: £162.777 million).

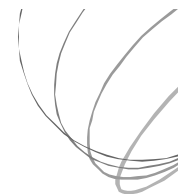


2007/08 Budget

9. NMS grant-in-aid allocation from Scottish ministers has been initially set at ££30.064 million for 2007/08. This comprises:
 - Revenue grant £20.278 million
 - Major capital of £2.400 million
 - Purchase grant of £0.710 million
 - Capital charges – non-cash revenue – of £6.676 million.
10. An additional funding package of £15.252 million over the next four years has been approved by the Scottish Executive for the Royal Museum Project, with £3.700 million payable in 2007/08.
11. The bulk of expenditure during 2007/08 will relate to staff costs and capital charges, albeit the latter are a non-cash item that counts towards NMS's overall budget. The main challenge facing NMS over the next few years is ensuring the successful completion of the RMS Project.

Issues arising from the audit

12. We reported the following issues to the Audit Committee on 16th August 2007.
13. **Accounting for revaluations in donated assets:** FReM requires that any revaluations of donated asset should be charged to a *Donated Asset Reserve* rather than a *Revaluation Reserve* – which is specifically for purchased assets. However, NMS is unable to separately identify revaluations relating to donated assets, and all revaluations are reflected through the Revaluation Reserve. An overall adjustment is therefore made each year, through apportionment of the revaluation reserve, to exclude donated asset values from cost of capital calculations. Nevertheless, current disclosures are not in accordance with the requirements of the FReM, and there is an increased risk that cost of capital charges are misstated based on this apportionment. Additional work needs to be carried out in this area to ensure there are appropriate records for donated assets.
14. **Internal Control assurances:** 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. NMS conducts such a review to support the Statement on Internal Control, but it is not formalised and documented per the requirements of the Manual. NMS has agreed to review its existing arrangements with the objective of formalising this process, possibly as part of the appraisal process for senior management.



Statement on internal control

15. The Statement on Internal Control (SIC) included within NMS accounts summaries the Accountable Officer's responsibilities for maintaining a sound system of internal control and the measures put in place to achieve this. The internal control systems and governance arrangements have been reviewed by internal audit and found to be generally satisfactory. The findings from our audit work have not identified any matters that are inconsistent with the statements and conclusions recorded in the SIC.

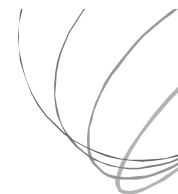
Regularity assertion

16. 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

17. 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.
18. 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.
19. NMS was successful in achieving funding from both the Heritage Lottery Fund and the Scottish Executive towards the cost of the refurbishment of the Royal Museum, which represents the largest commitment of funds to a cultural refurbishment project from both organisations.
20. NMS continued to work towards objectives set by the Scottish Executive by ensuring the widest possible involvement in cultural, social and sporting opportunities. Throughout 2006/07 visitor numbers to the various museums increased to some 1.4 million and there were over 4 million visits to the NMS website which was re-launched during 2006/07.



Governance

Overview of arrangements

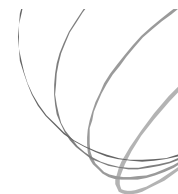
21. This section sets out our main findings arising from our review of NMS governance arrangements, including a review of internal audit.
22. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position (see paragraphs 7-8). Our overall conclusion is that arrangements within NMS are sound and have operated throughout 2006/07.

Systems of internal control

23. 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, the internal auditors provided an opinion that, based on the internal audit work undertaken during the year, there was moderate assurance on the adequacy and effectiveness of the systems of internal control. The internal auditors explained that the moderate assurance rating was due to certain weaknesses in the IT systems. We will monitor progress on this issue during 2007/08.
24. As part of our audit we reviewed the high level controls in a number of NMS's systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively.

Internal audit

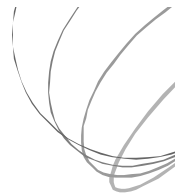
25. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2006/07 audit we assessed whether we could place reliance on NMS's internal auditors. 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

26. National Museums Scotland faces a number of challenges in 2007/08, which include:

- **Refurbishment of Royal Museum** - A major refurbishment of the Royal Museum is currently underway with a budgeted cost of £46.4m. This will require strong project planning, effective accounting procedures and sound arrangements for the storage and safe keeping of collections during the period of refurbishment. The project has been included in a forthcoming value for money study to be conducted by Audit Scotland on behalf of the Auditor General for Scotland, the results of which will be reported to the Audit Committee of the Scottish Parliament. The study includes a review of 20 major capital projects across the public sector in Scotland, and will focus on arrangements for planning, managing and delivering them within cost and timetable.
- **Best Value** – As part of the 2007/08 audit we will be reviewing the progress that the National Museums Scotland has made in strengthening their arrangements for securing Best Value since our 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.
- **Efficient Government** - The achievement of future Efficient Government targets represents a challenge for the organisation and its partner organisations.
- **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. NMS 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 FRoM and will therefore be applicable



to NMS. Given the extent of heritage assets owned by NMS, it is important that developments in this area are monitored closely by NMS Finance Department.

- **Change in internal audit provider** – The internal audit function is now provided by Baker Tilly (previously KPMG). We will continue to liaise with the internal auditor in order to maximise the extent to which we can place reliance on their work and thereby reduce the overall audit burden on NMS.