Key Issues Memorandum

National Archives of Scotland

For the year ended 31 March 2010

30 September 2010

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Grant Thornton

To the Accountable Officer, the Keeper and the Audit Committee of the National Archives of Scotland (NAS) and the Auditor General for Scotland

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The purpose of this memorandum is to highlight the key issues affecting the results of NAS and the preparation of the financial statements for the year ended 31 March 2010. It is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260. This memorandum should be read in conjunction with other reports issued by us during 2009-10 (Appendix D).

We take responsibility for this memorandum, which has been prepared on the basis of the limitations set out in 'The small print' (Section 7).

We would like to take this opportunity to record our appreciation for the assistance provided by the Accountable Officer, Scottish Government staff and NAS finance staff during our audit.

Grant Thornton UK LLP

Contents

1 Executive summary

Financial statements	
Audit opinion	• We intend to give an unqualified opinion on both the financial statements of NAS for 2009-10 and on the regularity of transactions undertaken during the financial year.
Financial statements	• The draft financial statements and supporting working papers presented for audit were generally of poor quality, with key information missing or incomplete. As a result, our audit took significantly longer than planned and a large number of audit adjustments were identified.
IFRS conversion	• We carried out a review of the draft 2009-10 IFRS accounts against the requirements of the iFReM. The annual accounts are IFRS compliant.

Governance	
Financial planning, monitoring and budgeting	• NAS significantly underspent in 2009-10 on both resource and capital budgets despite predicting throughout the year that the resource budget would be fully utilised. It is disappointing that planned improvements in financial planning, monitoring and budgeting arrangements have not yet been fully implemented.
Looking ahead - the future	• NAS has generally adequate governance arrangements in place. However, the time taken to address audit recommendations needs to improve.
National performance reports	• NAS has adequate arrangements for considering Audit Scotland national performance reports.

Performance and best value	
Best Value and Performance	• NAS needs to further develop its Best Value framework and update its key performance indicators to align with the corporate plan and become more outcome focused.
Efficiencies	• NAS exceeded its efficiency savings target for the year. However, the organisation faces a significant financial challenge going forward to maintain existing levels of service provision whilst achieving more challenging efficiency and business performance improvement.

2 Financial reporting

2.1 Summary of results

Figure 1: Summary of results

	Actual 2009-10 £000	Budget * 2009-10 £000	Actual 2008-09 £000
Operating cost statement			
Staff costs	4,340	4,300	4,485
Administration expenditure	4,359	4,346	7,038
Grants	25	25	25
Administration income	(1,180)	(800)	(1,101)
Net operating cost	**7,544**	**7,871**	**10,447**
Capital expenditure	**2,090**	**2,700**	**2,141**

**Budget as agreed at the Spring Budget Revision*

As summarised in figure 1 opposite, NAS achieved a net resource outturn of £7.544 million resulting in an underspend against operating budget of £7.871 million by £0.327 million.

NAS achieved a capital outturn of £2.090 million against a capital budget of £2.700 million, resulting in a capital underspend of £0.610 million.

The results leave NAS within the regularity limit.

2.2 Net operating costs - comparison to budget

The outturn of £7.544 million is under budget by £0.327 million (4.1%). This compares to an underspend in 2008-09 under UK GAAP reporting of £0.110 million (1%). The main areas of variance to budget as detailed in Figure 2 opposite were:

- underspend of £0.040 million on staff costs. This is principally due to higher capitalisation of staff costs than budgeted
- electricity costs included within accommodation costs were £0.100 million less than budget but maintenance costs within supplies and services were £0.126 million over the original budget. This is explained by the new maintenance contract coming into force during the year
- income was higher than expected due to the delay in the transfer of income from NAS to Registers of Scotland in connection with Registers Direct 2, higher search room charges, and an increase in staff secondments. The Registers Direct 2 project has been delayed and is not likely to become live until 2011. Search room activity was budgeted to continue to fall due to the economic crisis affecting property sales but, in the event, was higher than expected.

Figure 2: comparison to budget

	Actual 2009-10	Budget 2009-10	Variance (over)/under
	£000	£000	£000
Staff costs	4,340	4,300	(40)
Accommodation costs	1,683	1,623	(60)
Supplies & Services	1,251	1,300	49
Others	1,450	1,448	(2)
	8,724	8,671	(53)
Administration income	(1,180)	(800)	380
Net operating costs	**7,544**	**7,871**	**327**

2.3 Net operating costs - comparison to 2008-09

The outturn of £7.544 million is lower than the outturn of £10.447 million for 2008-09 by £2.903 million (28%). The principle reasons for this are:

- a reduction in staff costs because several higher paid employees left or retired and were not replaced. Although staff numbers increased overall, this was due to there being a higher number of temporary staff at lower salaries

- an increase in accommodation costs, as 2008-09 included a rates rebate of £0.215 million

- an impairment loss of £2.904 million in 2008-09 on completion of the renovation of General Register House

- an increase in income due to a higher amount of staff seconded out in the year compared to the prior year. Income from the ScotlandsPeople Centre was £0.050 million higher but this was offset by a reduction of a similar amount in legal search income.

Figure 3: Comparison to 2008-09

	2009-10	2008-09	Variance higher/(lower)
	£000	£000	£000
Staff costs	4,340	4,485	(145)
Accommodation costs	1,683	1,443	240
Supplies & Services	1,251	1,217	34
Impairment	-	2,904	(2,904)
Others - insignificant variances	1,450	1,499	(49)
Total expenditure	8,724	11,548	(2,824)
Administration income	(1,180)	(1,101)	(79)
Net operating cost	**7,544**	**10,447**	**(2,903)**

2.4 Financial position

Figure 4: Balance sheet - comparison to 2008-09

	Actual 2010	Actual 2009	Movement
	£000	£000	£000
Balance sheet			
Non-current assets	14,824	13,453	1,371
Current assets	571	497	74
Current liabilities	(580)	(524)	(56)
Provisions	(90)	(105)	15
Total taxpayers equity	**14,725**	**13,321**	**1,404**
General Fund	11,314	9,830	1,484
Revaluation Reserve	2,634	2,620	14
Donated Assets Reserve	777	871	(94)
	14,725	**13,321**	**1,404**

The main movements from 2008-09 are:

- an increase in non-current assets by £1.371 million due principally to the ongoing digitisation programme. Expenditure on the digitisation programme includes £0.622 million for staff whose time directly relates to the programme

- an increase in the General Fund because the additions to non-current assets meant that the cash funding requirement was higher than net cash expenditure

- property revaluations resulted in an increase to the Revaluation Reserve by £0.201 million, less depreciation of £0.187 million released to the General Fund

- a reduction in the Donated Assets Reserve due to depreciation charges on assets bought out of donated funds. The Scottish Government are still holding £0.043 million of unspent donations. This is included in current assets and will remain there until NAS request permission to use it for the specified purposes.

2.5 Conclusion

NAS is within the budget limits for both operating expenditure and capital expenditure.

However, the results are significantly under both the original budget agreed with Scottish Government and the Spring Budget Revision figures as shown in the following table:

Budget v costs *Figure 5*	Operating	Capital	Total
	£million	£million	£million
Original budget	7.6	2.7	10.3
Autumn Budget Revision	7.7	2.7	10.4
Spring Budget Revision	7.9	2.7	10.6
Actual	7.5	2.1	9.6

We comment further in Section 5 on financial planning, budget monitoring and control.

3 Financial statements audit

This section of our report details the key risks on the financial statements that we identified during our audit planning and further issues we identified during the audit, together with how we have addressed those risks during our audit of the financial statements.

NAS is required to produce financial statements under an Accounts Direction issued by the Scottish Ministers. The Accounts Direction requires NAS to prepare its financial statements in line with the accounting principles and disclosure requirements of the 2009-10 iFReM.

We audit the financial statements and give an opinion on whether they give a true and fair view. Our opinion also covers whether the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

We also review the Statement on Internal Control (SIC) and consider NAS's compliance with Scottish Government guidance, the adequacy of the processes put in place by the Accountable Officer to obtain assurances on systems of internal control and assess whether disclosures in the SIC are consistent with the information emerging from our normal audit work. We are not required to consider whether the SIC covers all risks and controls or to form an opinion on the effectiveness of NAS's corporate governance procedures or its risk and control procedures. This section of the report outlines the key risks we identified in our Audit Planning Memorandum in relation to the financial statements audit, and documents how we have addressed those risks during the year.

3.1 Response to issues identified in the Audit Approach Memorandum (AAM)

Specific issues identified in the AAM	Auditor Response
Outturn against budget Our 2008-09 audit report was qualified in respect of a breach of regularity as NAS had overspent against budget. The key audit issue in 2009-10, therefore, related to the effectiveness of NAS's financial management arrangements to prevent a similar outcome. Our audit had identified that. NAS was unable to forecast its financial outturn with accuracy and noted a large number of errors and omissions in the preparation of the 2008-09 financial statements. We, therefore, raised a high risk recommendation to improve financial management arrangements as a matter of priority.	We addressed the risk of error in the financial statements by increasing our audit effort to identify incomplete creditors and accruals through testing for unrecorded liabilities and tracing accrued income to supporting documents: • **Unrecorded liabilities**: NAS apply Scottish Government accounting guidance and only accrue amounts in excess of £10,000. We reviewed a sample of post year-end invoices and concluded that all invoices over £10,000 were appropriately recorded in the financial statements. We also reviewed a sample of invoices under £10,000 and have included a total unrecorded liability of £33,000 in the schedule of unadjusted errors within Appendix C • **Accrued income:** No significant adjustments arose from our substantive review of accrued income. We conclude that creditors and accruals were complete at the year end in all material respects. However, our audit did identify a large number of errors and omissions in the draft financial statements and these are detailed in Section 4.
Non-current assets NAS has significant tangible and intangible assets and revaluations and impairments could have a significant effect on the outturn for the year. NAS should consider the value of non-current assets in advance of the year end and ensure that appropriate adjustments for revaluation and/or impairment have been processed in the year end accounts prior to our audit.	NAS appropriately addressed this risk by obtaining valuations as at 31 March 2010 for its three buildings. This has resulted in a revaluation uplift of £0.201 million.

Specific issues identified in the AAM	Auditor Response
International Financial Reporting Standards (IFRS) Central government bodies are required to prepare their accounts on the basis of IFRS from 2009-10. In readiness for this, NAS prepared an opening 2008 IFRS-based balance sheet which we have already reviewed and reported on. NAS was required to produce full shadow IFRS accounts for 2008-09 by 30 November 2009. We received the shadow IFRS accounts for 2008-09 on 12 January 2010 and issued our report on 22 January 2010. Our review concluded that although there were some disclosure items to consider, the main areas had been appropriately addressed. In our Audit Approach Memorandum for 2009-10 we indicated that we would carry out a comprehensive review of the draft 2009-10 accounts against the requirements of the 2009-10 iFReM.	Several omissions were noted to the draft accounts including a full reconciliation between IFRS and UK GAAP. However, the final accounts are in compliance with the iFReM.
Commercial creditor There is a commercial creditor of £0.049 million (2008-09 £nil) relating to income posted into SEAS by Scottish Government staff which NAS are then required to allocate to the appropriate codes.	We have concluded that much of the income received into this account will be allocated out to the General Register Office for Scotland under the ScotlandsPeople Centre agreement, and would therefore be a valid creditor in NAS's financial statements. However, this account is not currently reconciled and cleared monthly by NAS. Management should improve monthly and annual controls to ensure that all balance sheet accounts are reconciled. **Appendix A, action plan point 1**

Specific issues identified in the AAM	Auditor Response
Staff costs capitalised As in the prior year, the element of staff costs that relates directly to the digitisation of records were capitalised within non-current assets. This calculation involves management judgement regarding the percentage of time spent by each member of staff on the capital project. We have requested detailed calculations with estimates of the time staff spend directly on the project.	Total staff costs capitalised this year are £0.622 million (2008-09 £0.464 million). We reviewed the calculation of the capitalisation of these staff costs and conclude that the adjustment is appropriate and reasonable. We require the Accountable Officer to provide us with a confirmation of his view of the accuracy of the calculation through the letter of representation. NAS should maintain appropriate time records for staff working on capital projects going forward. We also recommend that the value of staff costs capitalised, in this and the prior year, are disclosed within a note to the financial statements in line with the FReM. **Appendix A, action plan point 2**

3.2 Matters identified during the audit

Matter	Conclusion
Brightsolid contract In 2002, NAS, the General Register Office for Scotland and the Court of the Lord Lyon (the partners) jointly entered into a contract with Scotland Online (now Brightsolid) to provide pay per view internet services giving the general public access to a range of information that they hold in their registers and archives. On this basis, Brightsolid paid the partners a fee each month, which was calculated by Brightsolid at the rates agreed in the contract on the total income received by Scotland Online. No VAT was ever charged on the services provided by Brightsolid. The fee was split such that NAS received 5% of the total, the remainder going to the other partners. However, during 2009 Brightsolid began charging VAT on the cost element of the contract (approx £23k per month for 10 months in 2009-10). HMRC have advised that the VAT is not recoverable, adversely impacting the operating cost statement in the period.	As NAS receives 5% of this income, the effect on its operating expenditure during 2009-10 has only been approximately £1k per month. The current VAT position for all partner organisations and Brightsolid has yet to be resolved. We have recommended that the partners seek legal advice as to the contractual position on both the old and the new contracts. As the amounts are not material to NAS, we have not requested any disclosures within the accounts or management representations. We will follow up the outcome from this issue as part of our 2010-11 audit.
Statement on System of Internal Control (SIC) The Accountable Officer is required to report on the work he has carried out to ensure that NAS operates in accordance with the Scottish Public Finance Manual and that a sound system of internal control is operated.	We have reviewed the Statement on Internal Control (SIC) and considered NAS's compliance with Scottish Government guidance, the adequacy of the process put in place by the Accountable Officer to obtain assurances on systems of internal control and assessed whether disclosures in the SIC are consistent with the information emerging from our normal audit work. We are not required to consider whether the SIC covers all risks and controls or to form and opinion on the effectiveness of NAS's corporate governance procedures or its risk and control procedures. In view of the issues identified during the audit in relation to financial management, we recommend that the Accountable Officer updates the SIC to reflect this matter. **Appendix A, action plan point 3**

3.3 Control Findings

As part of our 2009-10 interim audit, we assessed the adequacy of NAS's financial systems in respect of:

- property, plant & equipment, and
- trade payables

We identified several areas for improvement in these systems and made some recommendations as reported in our earlier interim reports. See Appendix D for a full list of these reports.

We also identified a few additional control points as part of the year end audit. These additional points are detailed in Appendix A, together with our recommendations and management responses.

3.4 Conclusion

Although there are a number of areas of significant concern in relation to financial management and control which we comment on in Section 5 of this report, all material errors identified during our audit have been adjusted and the financial statements comply in all material respects with the iFReM. Therefore, we intend to give an unqualified opinion on both the financial statements of NAS for 2009-2010 and on the regularity of transactions undertaken during the financial year.

4 Audit adjustments

4.1 Adjusted misstatements

Adjustments that were identified by Grant Thornton and the management team during the course of the audit, and subsequently processed are shown in Appendix B.

4.2 Unadjusted misstatements

The aggregate impact of unadjusted misstatements on the Operating Cost Statement if they were processed would result in an increase in net operating costs of £0.26 million.

We agreed that the impact of unadjusted misstatements on the financial statements is less than material and therefore does not require adjusting. A full list of the unadjusted misstatements is shown in Appendix C.

5 Governance

5.1 Introduction

Corporate governance is the system by which organisations direct and control their functions and relate to their stakeholders, and incorporates the way in which an organisation manages its business, determines strategy and objectives and goes about achieving those objectives. It is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation.

5.2 Audit Approach

As part of our 2009-10 audit, we assessed the adequacy of NAS's governance arrangements against good practice standards for the public sector.

We examined:

- financial and budgetary management
- risk management
- prevention and detection of fraud and irregularity
- standards of conduct and arrangements in relation to the prevention and detection of corruption.

We reported in our interim 2009-10 report that budget setting, monitoring and reporting arrangements required significant improvement. In addition, we found that risk management could be further developed by the scoring of risks in the risk register and by updating branch risk registers.

Additional findings from the financial statements audit are detailed below.

<table>
<tr><th>Specific issue identified in the AAM</th><th>Response</th></tr>
<tr><td>Financial planning, monitoring and control
NAS had a budget overspend last year resulting in a qualified report on regularity, and the key point last year was that management could not forecast the final position with reasonable accuracy.

We considered that there was a high risk of uncertainty as to the final outturn for 2009-10 and a possible overspend on budget.</td><td>NAS has significantly underspent on both operating and capital budgets in 2009-10, but had been forecasting that it would fully utilise its revenue budget throughout the year and in management board papers to end May 2010. Management first became aware of the financial outturn when the first draft of the financial statements became available in June 2010. Our key findings are:

• the operating budget was significantly underspent, but the audit committee were advised in February 2010 that the outturn would be very close to budget and the management board were advised in May 2010 that the outturn would be only slightly under budget.

• NAS increased its budget for 2009-10 from £7.6 million to £7.9 million in the Spring Budget Revision (SBR), indicating its view that a potential overspend against original budget was likely

• the capital budget was underspent by £0.610 million. An underspend of £0.400 million had been reported to Scottish Government (SG) during the year but SG chose not to adjust NAS's budget provision for this. (The original capital budget award was based on the prior year when NAS had surrendered £0.500 million to the General Register Office for Scotland i.e. NAS anticipated large underspend.) However, the final underspend is some £0.210 higher than predicted at the time of the SBR, and £0.610 million higher than the original budget, indicating inadequate financial planning and control.

NAS is a relatively small, non-complex organisation and should be expected to be able to forecast and report its financial position with a relatively high degree of accuracy - especially close to the financial year end. It is disappointing to note that NAS has been unable to achieve this fundamental objective during this, and previous, financial years. NAS now needs to take urgent action to improve its budget setting, monitoring and financial reporting arrangements to reach the minimum standards expected for financial management..

Appendix A, action plan point 1</td></tr>
</table>

Specific issue identified in the AAM	Response
Financial reporting and audit Due to the unexpected long-term illness of a key member of the finance team, NAS was poorly prepared for the 2008-09 audit, information was late, incomplete and a significant number of audit adjustments were required. In addition, NAS had requested that the 2009-10 final audit take place in June 2010, earlier than in previous years. We were concerned that the same problems would arise in relation to 2009-10 and that the staff would not be prepared by June.	We arranged a meeting in March 2010 to agree our audit approach and timetable and issued a comprehensive working paper request list. However, many of the work papers that we had requested were not available on 14 June 2010 when the audit fieldwork commenced, and a significant number of supporting working papers contained errors or did not reconcile to the nominal ledger. This caused delays for the audit team and resulted in a requirement for additional fieldwork on 13 July 2010. We have outlined below some of the key errors identified from our audit of the draft financial statements: **Operating cost statement** • costs allocated in the OCS were not consistent with budget and prior year and therefore staff were unable to provide explanations for movements from budget and prior year values • budget information was omitted from the draft accounts. **Balance sheet** • the fixed asset register did not reconcile to the financial statements • Revaluation reserve workings were not provided and subsequently contained errors • trade and other receivables schedules, including VAT, had not been reconciled to the nominal ledger and client staff were initially unable to provide an explanation • trade and other payables schedules had not been reconciled to the nominal ledger and client staff were unable to provide an explanation • the provisions for early retirement were incorrect requiring an adjustment for £50,000 • the contingent liability disclosure had not been updated from the prior year.

Specific issue identified in the AAM	Response
	Statement of changes in taxpayers' equity • depreciation on donated assets had not been correctly treated in the donated asset reserve and resulted in adjustments included on the summary of adjusted errors • no transfer of depreciation to the revaluation reserve had been calculated and included in the revised statement. **The following information was incomplete or omitted from the draft accounts** • Remuneration report • Notes 1, 2, 3, 4, 5, 6, 8, 9, 15, 18, 19, 20 • KPI data We received 6 versions of the draft accounts from management and provided a detailed list of errors and omissions to management for correction following receipt of each version. This process added significantly to the time taken to complete the audit. Our audit has required adjustments to be made to all of the main account headings - the majority of errors related to the processing of journals to reverse opening debtors and creditors, the posting of depreciation, and an erroneous £50,000 adjustment to provisions. These errors took the audit team some time to identify and resolve, but are basic in nature and highlight the following issues: • NAS has inadequate year end closedown procedures • the finance team does not adopt basic financial disciplines in some key areas. In particular, processes to maintain reconciliations and process journals accurately need improvement • the annual accounts, and other key finance processes, are not subject to an

Specific issue identified in the AAM	Response
	adequate supervisory check • the training requirements of finance staff have not been reviewed by management and are not adequately addressed. **Appendix A, action plan point 9**
Financial position - future planning The economic recession will result in significant cuts in public sector funding as the UK Government faces material reductions in tax receipts, higher welfare payments and higher loan repayment costs. In the Scottish public sector recent estimates indicate a potential reduction of between 15% and 20% in public sector funding from 2011-12. NAS should ensure that the medium term financial and corporate planning, budgeting, forecast and risk assessments all consider these issues.	NAS has recently finalised its Corporate Plan for 2010-11 to 2012-13. The Corporate Plan sets out the main issues facing the organisation during the next few years such as the public sector funding cuts and the areas more specific to NAS such as how to archive electronic records, to recognise the move to online rather than onsite working, and how to plan for the loss of income from legal work. Key business objectives (KBOs) with specific completion dates have been set in order to achieve these strategic aims. By the end of July 2010, NAS had fully achieved 4 of the 6 KBOs that had been due to be completed by that date. The other 2 were partially complete, namely: • the marketing plan for the ScotlandsPeople Centre is being finalised in August 2010 • the IT systems contingency solutions has been implemented but the ICT Business Continuity Plan has not been aligned with the risk register yet. NAS has made reasonable progress during 2010-11 but needs to ensure that the timetables set for key business objectives set in the corporate plan are achieved. **Appendix A, action plan point 10**

6 Performance and best value

6.1 Introduction

All public bodies in Scotland have a duty to secure Best Value and continuous improvement. The public sector is facing a period of significant financial austerity, with budget cuts likely to be in the region of 15% - 20% in real terms by 2013-14. In many areas this means that the current level of service provision is unsustainable. Public pressure to deliver services as efficiently and cost effectively as possible means that being able to demonstrate that the organisation delivers Best Value is more important than ever.

We reported in detail on this area in our interim 2009-10 report. The following comments are intended to supplement the recommendations made in that report.

Specific issue identified in the AAM	Auditor Response
Audit Scotland Audit Scotland require auditors to provide feedback to them on the response by NAS to national performance reports in central government bodies. Where we find that NAS has not adequately considered a relevant national study report and/or has not prepared an action plan to implement relevant recommendations, we are required to discuss this with you and include a recommendation within our reports to you.	We found that NAS has procedures which ensure that relevant national performance reports are discussed at board and audit committee meetings and that action plans are prepared if required. We submitted a progress report to Audit Scotland in February 2010 in line with this conclusion, and are required to submit a further report by 31 August 2010. To ensure this process continues, we recommend that a standing point is added to management board and audit committee agendas. The national performance report of most relevance that has been published recently is "Improving Public Sector Efficiencies" published in February 2010 and we will expect NAS to have considered this study by the time of our final report to Audit Scotland. **Appendix A, action plan point 11**

Specific issue identified in the AAM	Auditor Response
Best value NAS is required to operate effectively and efficiently and demonstrate a commitment to the principles of Best Value.	Please refer to the findings in our interim report for 2009-10 issued in May 2010. In summary, we found that NAS is good at working in partnership with others and has developed several strong relationships with a number of partner organisations. However, the performance management framework requires further development to ensure that key performance indicators are more meaningful and measurable and in line with corporate plan objectives. Best Value principles need to be developed further supported by an action plan with responsibilities for executing each action assigned to a specific individual. We will include a review of progress on our recommendations in our 2010-11 audit plan.
Performance Our review of NAS's key performance indicators (KPIs) for 2008-09 noted that there is scope to ensure KPIs more accurately reflect corporate priorities set out in the corporate plan. The current performance indicators adopted by NAS tend to be input focussed, and there is scope for further development of outcome, output and impact performance measures, including measures of customer satisfaction.	As noted in our interim report for 2009-10 issued in May 2010 regarding the actual KPIs, we concluded that some indicators, such as the number of replies to correspondence, appear to have no link to strategic priorities. Others have limited connections, for example, the speed of productions to readers from same building and from another building. We also noted that these do not appear to be based on customer service standards or on consultation with users. Although the Corporate Plan sets targets for the current KPIs, there is no context to allow users to judge whether the targets are appropriate or challenging. In addition, no trend or comparator information is provided. We note that the Corporate Plan 2010-11 to 2012-13 still uses the same KPIs as in previous years although the management board minutes of May 2010 state that the KPIs will now be recast. We reviewed KPIs for 2009-10. There were 10 KPIs and 4 of these were not achieved, but did not miss the targets significantly. **Appendix A, action plan point 12**

Specific issue identified in the AAM	Auditor Response
Efficient government The Scottish Government set NAS a target to achieve £0.158 million per annum in efficiency savings in 2009-10 to 2010-11. NAS achieved its efficiency savings target for 2008-09, but faced a significant challenge to continue to meet expected efficiency savings at current levels of service provision.	Outturn efficiencies of £0.234 million for 2009-10 were reported to the Scottish Government against the target of £0.158 million set. However, these savings are made up from reductions in staff costs through not replacing employees who leave and NAS must be able to demonstrate that such savings do not effect service quality or outcomes. We note that the minutes of the May 2010 management board meeting requested that: • future financial reports should include a heading detailing efficiency savings • the sustainability of retaining efficiency savings such as leaving staff posts unfilled must be able to be demonstrated • management board meetings will in future record the scrutiny of efficiency savings. We understand that NAS are currently in the early stages of planning for the 2010-11 efficiency savings. **Appendix A, action plan point 13**

7 The small print

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- the form of reports expected

Purpose of memorandum

This Key Issues Memorandum has been prepared for the benefit of discussions between Grant Thornton, the Audit Committee and the Board of management.

The purpose of this memorandum is to highlight the key issues affecting the results of NAS and the preparation of the organisation's financial statements for the year ended 31 March 2010.

This document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the organisation.

This memorandum is strictly confidential and although it has been made available to management to facilitate discussions, it may not be taken as altering our responsibilities to the organisation arising under the Code of Audit Practice.

The report will be submitted to the Auditor General for Scotland and will be published by him on his website at **www.audit-scotland.gov.uk.**

Responsibilities of the Board, Accountable Officer and auditors

The Board and Accountable Officer are responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the Board and Accountable Officer confirm that our understanding of all the matters in this memorandum is appropriate, having regard to their knowledge of the particular circumstances.

Clarification of roles and responsibilities with respect to internal controls

NAS's management is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to the Board and Accountable Officer that it has done so.

The Board and Accountable Officer are required to review the organisation's internal financial controls. In addition, they are required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Board and Accountable Officer should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by internal audit or ourselves.

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

Independence and robustness

Ethical standards require us to give you full and fair disclosure of matters relating to our independence.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

In accordance with best practice, we analyse our fees below:

	£ incl VAT
Grant Thornton UK LLP	59,000
Audit Scotland fixed charge	6,400
Total	**65,400**

A Action plan

No	Finding	Risk	Recommendation	Management Response	Implementation Date
Financial management and control					
1	**Budgeting, financial monitoring and control** NAS was significantly underspent against budget but, most importantly, was unaware of the actual outturn until several months after the year end and for most of the year, thought they were going to be very close to budget. Budgeting, financial monitoring and control procedures require significant improvement. Part of the problem at the year end was that journals from 2008-09 were not processed until late in 2009-10 and then were incorrectly done with no review and checking process.	High		We concede that we were over cautious in reporting our projected financial outturn. In light of the overspend which occurred in the previous financial year, we accepted a £200k transfer from GROS at Autumn Budget Revision to ensure we had full cover for potential costs the ScotlandsPeople Centre. A further transfer of £100k from GROS in respect of accommodation staff costs at year-	

No	Finding	Risk	Recommendation	Management Response	Implementation Date
				end had not been anticipated. Taken together these resulted in a much higher underspend than forecast. Journals were processed late, but were subject to review and further adjustment by SG-ASU. There was a temporary loss of support from ASU during the year as personnel changed.	
			NAS must ensure that journals are correctly reversed at 1 April 2010 to give a correct opening trial balance, and this should be done as soon as possible.	Accepted.	30/09/10
			Month end and year end procedures should include a reconciliation of control accounts and should ensure these are correctly cleared on a regular basis. In addition, these reconciliations should be subject to review.	The main control accounts concern VAT and these are reviewed quarterly. We accept the need to clear these quickly.	30/09/10

No	Finding	Risk	Recommendation	Management Response	Implementation Date
			The monthly management accounts should:		
			• account for monthly movements in accruals and prepayments	Question the need to do this monthly? For further discussion.	
			• compare each budget heading to budget	Accepted. Now being done	31/07/10
			• provide explanations of variances to budget and detail action required	Accepted. Now being done	31/07/10
			• be made available to budget holders on a timely basis, who should account for variances against budget.	Accepted. Now being done. Staff and accommodation costs account for the great majority of the NAS budget and these are monitored very closely at the Centre. Most Branch Heads have very limited budgetary responsibilities.	31/07/10
			We recommend a guide published by the National Audit Office called "Financial	Noted.	

No	Finding	Risk	Recommendation	Management Response	Implementation Date
			management and Government Practice : Reporting financial management information to the Board".		
2	**Capitalisation of staff costs** The capitalisation of staff costs involves estimation techniques and management judgement.	Medium	To improve the accuracy of the calculation, we recommend that a sample of staff who are involved in the project are asked to keep a timesheet or log book for a sample period each year, say one or two weeks. We will request sight of this during the 2010-11 audit.	Accepted.	31/10/10
3	**Statement of Internal Control (SIC)** We identified a significant number of issues in relation to financial management and control.	Low	In view of the issues identified, we recommend that the Accountable Officer makes some reference in the SIC to these and states what action will be taken to resolve them.	Accepted.	17/08/10
4	**VAT** VAT returns are not being reconciled to the nominal ledger and have resulted in an accumulating difference of £19k by 31 March 2010. There was a smaller difference at the prior year end that was below the level of our materiality for the audit but that we had pointed out to the finance staff. There is a risk of fines and charges for incorrectly completing VAT returns.	Low	VAT returns should be reconciled to the nominal ledger each quarter to ensure that tax reclaims are maximised. The reconciliation should be reviewed.	Accepted.	30/09/10

No	Finding	Risk	Recommendation	Management Response	Implementation Date
5	**Sales invoicing** Some sales invoices were being raised with 30 day payment terms despite the agreed term being only 14 days.	Low	Sales invoices should be reviewed by someone senior prior to being issued.	Accepted, but note that all contracts are not on 14 day payment terms, some are correctly on 30 day terms	31/08/10
6	**Unused bank account** There is an open bank account that has not been used for at least 2 years and is therefore a fraud risk.	Medium	Management should consider closing unused bank accounts.	Agreed. An account with BoS was opened in anticipation in preparation for the SG changing their bank. This did not materialise so we will take steps to close this account.	30/09/10
7	**Journal posting** Senior financial personnel are not restricted from making journal entries. There is therefore a fraud risk related to the lack of segregation of duties.	Low	Senior financial reporting personnel should be restricted, through IT controls, from processing journal entries. In addition, user access rights in SEAS should be reviewed periodically.	We are not clear what the fraud risk is, given that there is an audit trail throughout the process, but would be happy to discuss further and make subsequent changes to access controls as agreed	30/11/10

No	Finding	Risk	Recommendation	Management Response	Implementation Date
8	**Fixed asset register** We noted some inconsistencies in the depreciation rates applied to various assets within the fixed asset register. For example, some assets in relation to the ScotlandsPeople Centre are still labelled as "assets under construction" and so are not depreciated. The depreciation is currently immaterial to the financial statements but will become larger as time goes on. In addition, there is a brought forward and carried forward difference on the revaluation reserve that should be cleared. As this has no net effect on the balance sheet, no adjustment was processed this year.	Low	We recommend that the fixed asset register is comprehensively reviewed during 2010-11 to ensure that items are depreciated as appropriate, and is tidied up by removing obsolete or scrapped assets. In addition, the revaluation reserve should be reviewed and adjusted in the 2010-11 accounts.	Accepted. , work on this is ongoing Accepted	31/12/10 31/12/10
Governance					
9	**Year end accounts and audit** The accounts and supporting working papers presented for audit were incomplete and subject to a large number of errors and it was clear that the closing trial balance had not been sense checked. Many of the problems delaying the audit process could have been prevented through improving year-end procedures at NAS.	High	We have agreed that we will hold a training session with the NAS finance team during 2010-11. We will explain in detail what we require for the audit and in what form. There will also be the opportunity for feedback from NAS staff on the audit process. In relation to year end close down procedures, we recommend a guidance available on the National Audit Office website entitled " Ready, Steady, Go…a practical guide to preparing for Faster Closing". All year end work should also be reviewed by a more senior member of staff.	We welcome the offer of the training session and think this will be very beneficial to all of us. The relationship between NAS and SG-ASU still need to be clarified and we are working together to achieve this Noted	31/12/10

No	Finding	Risk	Recommendation	Management Response	Implementation Date
			Most of the issues could be prevented by improving monthly procedures - see our further recommendations at action plan point 1 above.		
10	**Financial position - future planning** NAS has made reasonable progress during the start of 2010-11 but needs to ensure that the timetables for KBOs as set in the corporate plan are achieved or there is a risk that NAS is not sufficiently prepared for the significant funding cuts that are expected from April 2011.	High	We recommend that the management board receive monthly reports on progress against KBOs.	We think we have made good progress on our financial planning for 2011-12 onwards and are meeting all of the demands being placed upon us by SG in this regard. We will ask board members if they feel it would be helpful to have monthly reports on KBOs rather than the current quarterly ones	30/09/10
Performance					
11	**Audit Scotland national performance reports** Audit Scotland expect bodies to take account of their reports on performance and to put in place action plans as appropriate.	Low	We recommend that the agendas for meetings of the management board and the audit committee contain a standing point for the consideration of new reports published.	Accepted	31/08/10

No	Finding	Risk	Recommendation	Management Response	Implementation Date
12	**Performance** The management board have requested that KPIs be recast so that they are aligned to the corporate plan and are more customer and outcome focused.	Medium	The KPIs should now be recast and a timetable specified for completing this task.	Accepted. Outcomes of the strategic review will inform KPIs, which will be incorporated in the next version of the Corporate Plan	31/12/10
13	**Efficient government** The management board have requested monthly reporting to them on efficiencies.	Medium	Monthly reports to the management board should include the information on efficiencies requested by the management board.	Again, we will ask board members if they feel it would be helpful to have monthly reports on efficiencies, but in any event these will be now be reported quarterly to MB meetings	30/09/10

B Adjusted misstatements

Description	Operating cost statement		Balance sheet		Impact on results
	DR £k	CR £k	DR £k	CR £k	£k
Draft net operating cost					**7,411**
Major maintenance	33				**33**
Rates	7				**7**
Trade creditors				40	
Income	257				**257**
Sundry debtors				257	
Being reversal of erroneous year-end journals					
Sundry creditors			117		
Property, plant and equipment				117	
Being impact of reversal of prior year accrued assets					
Provision for early retirement			14		
Sundry creditors				14	
Being correction to show unwinding of retirement provision					
Provision for early retirement			50		
Employee costs		50			**(50)**
Being reversal of a general provision					
Depreciation		94			**(94)**
Donated asset reserve			94		
Being adjustments to donated asset reserve					
Debtors			65		
Income		65			**(65)**
Being debtor re Scottish Catholic Archives					
					45
Cost of capital	45				
General fund				45	
Being increase to cost of capital following audit adjustments					
Final net operating cost					**7,544**

C Unadjusted misstatements

Description	Operating cost statement		Balance sheet		Impact on results
	DR £k	CR £k	DR £k	CR £k	£k
OCS	33				**33**
Sundry creditors				33	
Being impact if £10k accrual policy was not applied					
Property, plant and equipment			12		
OCS		12			**(12)**
Being impact of Q4 salaries for GROS staff used in digitisation					
Income	2				**2**
Deferred revenue				2	
Being deferral of SPC season ticket revenue relating to 2010-11					
Income	3				**3**
VAT debtor				3	
Being reversal of output VAT element of accrued income					
Net impact on operating cost statement					**26**

D Reports issued in 2009-10

This Key Issues Memorandum should be read in conjunction with the following reports were issued during 2009-10:

Report	Issue date	Area covered
Audit Approach Memorandum	Jan 2010	Sets out plan of interim and final audit work.
2009-10 audit - follow up on 2008-09	May 2010	Follow up on the action plans agreed in 2008-09 including points from the interim report and KIM. Outstanding points will be followed up at the 2010-11 interim audit.
2009-10 interim management report	May 2010	Review of the interim audit findings and a new action plan for 2009-10 issues only. This action plan will be followed up at the 2010-11 interim audit.

Grant Thornton