

National Museums Scotland

Report on the 2009/10 Audit to the National Museums
Scotland and the Auditor General for Scotland

7 October 2010



 AUDIT SCOTLAND



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Key messages

In 2009/10 we looked at the key strategic and financial risks being faced by National Museums Scotland (NMS). 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 NMS for 2009/10. 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

Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight. It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known. Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the smaller budget available. In the current economic climate difficult decisions will have to be made across the public sector about priority spending programmes.

The Scottish Government set a resource budget for NMS of £36.188 million for 2009/10, comprising an operating budget of £30.772 million and a capital budget of £5.216 million (excluding the National Fund for Acquisitions which NMS manage on behalf of the Scottish Government). The operating budget included non cash items for cost of capital at £5.764 million and depreciation and impairment at £3.706 million. NMS operated within the overall resource budgets for cash and non-cash items, with a net under spend on non-cash of £387,000. Over the year, its net asset position increased by £6.925 million to £209.862 million, due mainly to capital works on the Royal Museum project.

Scottish Ministers have agreed a resource budget for NMS of £37.218 million for 2010/11. Working within this budget represents a significant challenge to NMS given the need to make efficiency savings of 2% per annum whilst absorbing pay inflation and other cost pressures, particularly the need to address an estate maintenance backlog of £16.3 million. Effective budget monitoring arrangements therefore remain crucial to NMS achieving its financial targets and delivering its objectives within tighter financial settlements. Given the potential for volatility in non-cash charges, including property valuations and impairments, it is important that NMS monitor these closely in-year.



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 NMS 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

NMS reports that it met or exceeded all of its performance indicators set by the Scottish Government, except one. The exception relates to environmental aims which were all below target, due mainly to difficulties in obtaining reliable estimates of outcomes.

Looking forward

The final part of our report highlights some key issues for NMS going forward, including some national issues which affect all public sector bodies. These include: the completion of the Royal Museum Project; the impact of future funding constraints; addressing a significant maintenance backlog and, the implementation in 2010/11 of *FRS 30 – Heritage Assets*.

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



7 October 2010



Introduction

1. This report summarises the findings from our 2009/10 audit of NMS. The scope of the audit was set out in our Audit Plan in accordance with the Code of Audit Practice, which was presented to the Audit Committee on 26 March 2010. 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. Our audit work for this year has been completed with no significant issues arising.
3. Best value duties apply across the public sector and are 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 this has been further developed during 2009/10 with the completion of its bank of best value Toolkits which, although primarily designed for audit use, are available to all public bodies for reference.

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





4. A linked development here has been the Scottish Government's work to refresh its 2006 best value Guidance for Public Bodies. This latter initiative, due for issue later in 2010, will result in clearer guidance to public bodies, and particularly those in the Central Government and Health sectors, on securing continuous improvement in performance, with due regard to the balance between cost and quality.
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. Where these have a bearing on the activities, risks or performance of NMS, we make reference to these reports in this document. 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 management and staff 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.



Financial Statements

7. In this section we summarise key outcomes from our audit of NMS financial statements for 2009/10 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

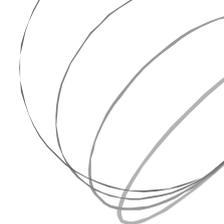
8. We audit the financial statements and give an opinion on:
- whether they give a true and fair view of the financial position of NMS and its expenditure and income for the period in question
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
 - the consistency of the information which comprises the Report of the Board of Trustees, the Statement on Internal Control and the unaudited part of the Remuneration Report, with 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 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

10. We have given an unqualified opinion on the financial statements of NMS for 2009/10.
11. The unaudited accounts were provided to us on 9 July 2010, supported by a comprehensive working paper package. We concluded our audit within the agreed timetable and provided our opinion to the Audit Committee on 13 August 2010 as timetabled.

Issues arising from the audit

12. As required by auditing standards we reported to the Audit Committee on 13 August 2010 the main issues arising from our audit of the financial statements. The key issues were as follows:



13. **Revised Management Statement and Financial Memorandum** – For several years we have highlighted the delays by the Scottish Government in issuing an updated Management Statement and Financial Memorandum, and this remains outstanding. As stated in our report to the Audit Committee last year, in our view the delay in issuing revised memoranda continues to undermine accountability arrangements between NMS and the Scottish Government.
14. **Register of interests** – During our audit we found that NMS' 2009/10 register of interest declarations had not been completed for the senior management team for the financial year. We also noted that management team declarations were not included in the register of interest published on the NMS website, although Trustee declarations were published. NMS arranged for SMT declarations for 2009/10 to be made available to audit prior to the accounts being signed by the accountable officer. Management team declarations will in future be collated as part of the accounts preparation process and published on the register of interests along with Trustee declarations.
15. **Valuation of the Royal Museum Building** – In response to audit issues raised last year, NMS had agreed to review the valuation of the Royal Museum Building in 2009/10 in order to ensure that the valuation complied with FReM requirements. We discussed and agreed with NMS Finance staff that it would be more appropriate to defer the review until the Royal Museum Project is complete and the building is brought back into use, at which time a full revaluation is planned. A review will be carried out in 2011/12 to coincide with a full revaluation of the building.
16. **NMS Charitable Trust (NMSCT)** – In our ISA 260 Letter on last year's accounts we advised the Audit Committee that in 2009/10 we would review the relationship between NMS and the NMSCT in order to establish whether NMSCT was effectively operating as a subsidiary or quasi subsidiary of NMS. The review has been completed and our findings were reported to NMS on 25 May 2010. We concluded that the NMSCT was not operating as a subsidiary or quasi subsidiary of NMS.

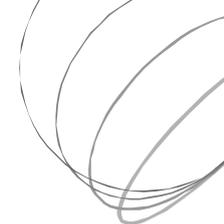
Regularity

17. 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)

18. UK government departments and other public sector bodies, excluding registered charities, prepared their accounts in accordance with International Financial Reporting Standards (IFRS) for the first time in financial year 2009/10 as part of an early adoption policy decided by UK Ministers. Over the next few years, registered charities in the UK, such as NMS, will be required to prepare their accounts in accordance with IFRS under a slower timetable for convergence as determined by the UK Accounting Standards Board. However, a detailed timetable for the transition to IFRS has still to be decided. In the meantime, it is important that NMS take appropriate preparatory steps in anticipation of the transition, particularly in regard to training of staff in the finance department on revised financial reporting disclosures and formats of accounts.



Use of Resources

19. 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 NMS' financial position.

Financial Position

Outturn 2009/10

20. NMS is required to operate within its resource budget as set out in the Grant in Aid offer letter from the Scottish Government. In 2009/10 NMS operated within the Grant in Aid offer for cash and capital expenditure – see exhibit 2 below.

Exhibit 2 – Performance against resource budget 2009/10 (£ 000s)

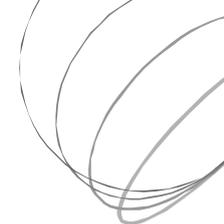
Limits	Grant in aid offer	Actual Outturn
Operating costs	21.302	21.302
Purchase grant	0.510	0.510
National Fund for acquisitions	200	200
Capital – Royal Museum Project	3.961	3.961
Capital – Granton extension	0.500	0.500
Capital – Other	0.245	0.245
Cost of capital	5.764	5.792 ¹
Depreciation and impairment	3.706	3.291 ²
Total	36.188	35,801

21. NMS's consolidated balance sheet at 31 March 2010 shows total net assets of £209.862 million compared to £202.937 million in 2008/09, with the increase due mainly to capital works on the Royal Museum.

22. The excess of expenditure over income after taxation, per the Income and Expenditure Account, decreased from £32.644 million in 2008/09 to £30.766 million in 2009/10. The decrease is due mainly to a combination of reduced depreciation charges and reduced maintenance costs. The going concern basis of the accounts is not affected by this situation due to continued funding from the Scottish Government, and appropriate disclosure to that effect is made in the accounts.

¹ Outturn adjusted for those assets not funded by GIA]

² Outturn adjusted for those assets not funded by GIA]



23. NMS is currently carrying out a major refurbishment of the Royal Museum in a £48 million project funded jointly by the Scottish Government, Heritage Lottery Fund and NMS own resources (mainly specific fund raising). The major building works are largely complete, and work is now progressing on internal refurbishment. Overall, the project appears on track and within budget and is due to be completed around September 2011.

Scotland's public finances

24. The Auditor General's report on *Scotland's public finances, published in November 2009*, contained an overview of the financial environment in Scotland and the pressures and challenges facing the public sector. The aim of this report was to help to inform the debate on the future of public finances in Scotland. The key messages from this report were:

Extract from Auditor General's report *Scotland's public finances*

The public sector is coming under the greatest financial pressure since devolution.

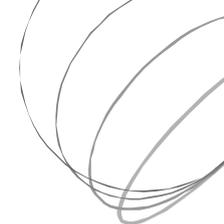
- Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight.
- The Scottish Government and the wider public sector need to work together to develop better activity, cost and performance information. This information is needed to enable informed choices to be made between competing priorities, and to encourage greater efficiency and productivity.

The Scottish Government faces significant challenges in balancing the budget while also delivering on its commitments and meeting increasing demands for public services.

- It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known.
- In many cases, the public sector uses income from various sources to pay for services. Income levels anticipated before the recession are unlikely to be realised, reducing the amount available to spend.
- The Scottish public sector faces significant challenges in balancing its budget while also delivering on its commitments. Changes in Scotland's population and rising unemployment rates will increase demand for public services.
- Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the smaller budget available.

In the current economic climate difficult decisions will have to be made about priority spending programmes.

- The Scottish Government's annual budget is largely developed on an incremental basis which involves making adjustments at the margin to existing budgets. This approach is not suitable for budgeting in a financial downturn because it does not easily allow informed choices to be made about priorities, based on robust information about activity, costs and performance.
- The Scottish Parliament has an important role in scrutinising the government's spending plans. Better information linking spending to costs, activities and service performance, and a rolling programme of performance reviews, would support the Scottish Parliament in fulfilling this role.



25. Against that background, NMS is anticipating a significant reduction in real terms of its annual funding from the Scottish Government over the next three years. All areas of its operations are being reviewed in order to maximise efficiencies, maximise income generation and identify potential cost savings. Its ability to maintain its operations at current levels with the addition next year of the newly refurbished Royal Museum, represents a significant challenge. NMS' financial constraints are exacerbated by an estate maintenance backlog of circa £16.3 million pounds that poses a significant risk to the safety of its collections. NMS are meeting with Scottish Government officials to agree a longer term funding package to address this particular issue.

Financial sustainability and the 2010/11 budget

26. Scottish Ministers have approved Grant in aid for NMS of £ 33.661 million for 2010/11, as set out below:

Exhibit 3 – 2010/11 Resource Plan (£ million)

Limits	Budget
Cash items	£m
Operating costs	21.325
Purchase grant	0.510
Capital – Royal Museum Project	3.330
Capital – Granton extension	1.600
Non cash items	
Cost of capital	5.879
Depreciation and impairment	4.354
Total	37,218

27. Within the current spending review period ending 31 March 2011, NMS is expected to achieve 2% year on year efficiency savings. In addition, 2010/11 budgets have not been uplifted as planned, resulting in a further savings target of £191, 000. NMS is on track to meet its savings targets, mainly through a combination of improved efficiencies, cost cutting and cancelled programmes. However, delivering efficiencies year on year while absorbing pay inflation and other cost pressures represents a significant challenge for NMS, particularly in this final year of the spending review targets. Effective budget monitoring arrangements are therefore crucial if NMS is to achieve its financial targets and deliver its objectives within tighter financial settlements.



Governance and Accountability

28. 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 NMS arrangements.
29. 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

30. This year we reviewed:
 - key systems of internal control
 - internal audit
 - arrangements for prevention and detection of fraud and irregularities, including standards of conduct.
31. Our overall conclusion is that arrangements within NMS have operated satisfactorily through 2009/10.

Systems of internal control

32. 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 2009/10 Baker Tilly UK, the internal auditors, provided their opinion that based on the internal audit work undertaken during the year, there was adequate assurance on the adequacy and effectiveness of the systems of internal controls.
33. As part of our audit we reviewed the high level of controls in a number of NMS systems that impact on the financial statements. This audit work covered a number of areas including budgetary control, staff costs and purchases. Our overall conclusion was that key controls were operating effectively and that NMS has adequate systems of internal control in place.



Statement on Internal Control

34. The Statement on Internal Control provided by NMS's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out NMS's approach to this. The Statement on Internal Control also highlighted an estate maintenance backlog of circa £16.3 million pounds that poses a significant risk to the safety of its collections. NMS is in discussion with the Scottish Government on how to address this issue.

Internal Audit

35. 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 NMS's internal audit function. We concluded that NMS's internal audit providers, Baker Tilly UK, operate in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in a number of areas during 2009/10, as we anticipated in our annual audit plan. This included reliance on aspects of internal audit's systems work to avoid duplication of effort.
36. The internal audit function was re-tendered in May 2010 and new internal auditors – KPMG – have been appointed for three years commencing October 2010.

Prevention and detection of fraud and irregularities

37. NMS has adopted the relevant procedures and guidance contained in the Scottish Public Finance Manual. It 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 covering gifts and hospitality.



Performance

38. 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.
39. In this section we comment on:
- NMS's vision and strategic direction
 - performance
 - risk management
 - efficiency.

Vision and strategic direction

40. The principal functions of NMS as set out in Section 2 (1) of the 1985 National Heritage (Scotland) Act, are to:
- care for, preserve and add to the objects in the national collections
 - secure that the objects are exhibited to and interpreted for the public
 - secure that the objects are available to persons seeking to inspect them in connection with study or research
 - generally promote the public's awareness, appreciation and understanding of matters agricultural, archaeological, architectural, artistic, cultural, environmental, historical, industrial, military, scientific and social, both by means of the Board's collections and by such other means, including collaboration with other institutions, as they consider appropriate
 - provide education, instruction and advice and carry out research.



41. NMS updated its 2006-2012 corporate plan in May 2010. The revised plan continues to focus on NMS's strategic aims and objectives under eight main headings. These are linked to its principal functions as set out above, and are now also linked to the Scottish Government's National Outcomes targets. Over the coming year NMS plans to review its long term vision and strategic framework to take account of the tight financial constraints now in place across the public sector.

Performance

42. NMS's key performance targets are set out in Section 7 of its updated Strategic Plan 2006-2012. The performance indicators are reported to each meeting of the Trustees and to the Scottish Government on a quarterly basis. During the year NMS met or exceeded most of its main performance indicators: visitor numbers were 1.26 million against a target of 1.12 million, despite the temporary closure of the Royal Museum for refurbishment; loans for display were 2,207 against a target of 1,200; the number of academic publications was 110 against a target of 100 and; environmental targets were achieved mainly through lower waste production.
43. The NMS Board regularly reviews performance against the corporate plan through quarterly performance reports. The reports are discussed in Board meetings and action taken to resolve any issues.

Risk management

44. The Board is responsible for identifying, managing and reviewing corporate risks and the effectiveness of actions identified to control these risks. The Board has put in place robust systems for the identification and management of risk, which includes the establishment of a Risk Management Group with responsibility for overseeing risk management processes across NMS. The Audit Committee also reviews the risk register at each of its meetings as a standing agenda item.
45. The main risks reported during 2009/10 relate to:
- delivery of the Royal Museum project on time and within budget, and in particular meeting internal funding targets for the project
 - addressing a maintenance backlog of £16.3 million that poses a risk to the safety and security of its collections.
46. NMS has put measures in place to address these risks. An executive committee with Trustee representation is responsible for overseeing the specific risks associated with the Royal Museum project and an estates strategy has been prepared for the period to 2012 to help identify, prioritise and



manage maintenance requirements. NMS is in discussion with the Scottish Government regarding funding to help meet current and future maintenance requirements.

Improving public sector efficiency

47. The Audit Scotland report *Improving public sector efficiency* was published on 25 February 2010. It provides a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in the 2006 report about the previous efficiency programme.
48. The report found that Scottish public bodies reported more efficiency savings than the Government's two per cent target. But, there are serious financial challenges ahead – the biggest since devolution – and making the required savings through efficiency will become increasingly difficult.
49. The report recommended that to deal with reduced future funding and increase savings public bodies need to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and improving collaboration and joint working.
50. The drive to improve efficiency and productivity is not just an exercise for managers and service providers. It requires strong leadership and engagement from the very top of public bodies. Leaders and senior decision-makers within an organisation have a responsibility to check, challenge, monitor and support their organisations in delivering efficiency and productivity improvements. The report's recommendations highlighted areas that public bodies' key decision-makers should look at to assess their organisation's development and to challenge existing arrangements (see below).



Extract from Audit Scotland report *Improving public sector efficiency*

In order to improve the delivery of efficiency savings public bodies should:

- ensure they have a priority-based approach to budgeting and spending
- continue to improve collaboration and joint working, overcoming traditional service boundaries
- consider using alternative providers of services, if these providers can improve the efficiency, productivity or quality of services
- improve information on costs, activity, productivity and outcomes, including setting baselines to measure performance against
- give greater urgency to developing benchmarking programmes
- maintain the momentum of activities and initiatives to improve purchasing and asset management and extend shared services
- ensure there is a joined-up approach to efficiency savings across the public sector, avoiding duplication
- ensure that plans are in place to deliver savings, clearly setting out what action will be taken, the level of savings to be delivered and how these will be measured
- strengthen the involvement of front-line staff, service providers and users in redesigning public services
- reduce reliance on non-recurring savings to meet financial targets and generally use these as part of a wider and longer term strategy
- report efficiency savings consistently.

51. To support these high-level recommendations, Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office have drawn on their combined experience to develop a detailed good practice checklist. The checklist is intended to promote detailed review and reflection and, if necessary, a basis for improvement. We recommend that those responsible for leading efficiency and improvement work should consider assessing themselves against each question, and recording the results.
52. As part of the 2008/09 to 2010/11 Spending Review settlement, NMS was set a target to achieve cash-releasing efficiency savings of 6% over the period. This target has been increased for 2010/11 by £191,000 due to suspension of grant uplift in that year.
53. NMS has identified savings and budget restrictions of over £1.1 million as part of the budget process for 2008/09 and 2009/10, and has to find an additional £0.276 million savings for 2010/11. A significant element of the anticipated savings will come from reductions in staff and operational costs. Achieving these targets represents a significant challenge for NMS given increasing cost pressures from both staff and suppliers. We will continue to monitor the financial position and the actions taken by NMS to manage the budget. There are no other specific efficiency targets set for NMS.



Looking Forward

54. NMS faces a number of challenges in 2010/11, which include:

- **Delivering the Royal Museum Project** – Delivering a project of this nature and scale within budget and time, and achieving its internal funding target of £12 million for the project, is a major challenge for NMS given the current financial climate.
- **Efficiencies and future funding** - Scottish public bodies reported more efficiency savings than the Government's two per cent target in 2008/09, but there are serious financial challenges ahead – the biggest since devolution – and making the required savings through efficiency will become increasingly difficult. To deal with reduced future funding and increase savings fresh approaches to improving efficiency and productivity must be considered, taking a more fundamental approach to identifying priorities, improving the productivity of public services and improving collaboration and joint working. NMS will therefore need to liaise closely with the Scottish Government on how to manage the impact of funding constraints on NMS operations.
- **Maintaining the NMS estate** – a recent estate condition survey commissioned by NMS identified a maintenance backlog of £16.3 million, which poses significant risks to the safety of NMS collections and could give rise to impairment charges. NMS is in discussion with the Scottish Government on the need for additional funding to address this situation. Against a background of wider public sector financial constraints, this is a particularly difficult issue to resolve, and will remain a major challenge for NMS over the next few years.
- **Heritage assets** – *Financial Reporting Standard 3-Heritage Assets* is applicable to accounting periods commencing on or after 1 April 2010 and contains significant new disclosure requirements for reporting the content and value of heritage assets. NMS will need to ensure that its staff are properly trained in the requirements of the standard.
- **Implementation of IFRS** – Although the UK Accounting Standards Board has still to announce an implementation date for the application of IFRS to charity accounts, their introduction is imminent and NMS will need to ensure that its staff are properly trained in the new requirements.