Key Issues Memorandum

National Archives of Scotland

For the year ended 31 March 2011

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To the Accountable Officer, the Keeper of the Records of Scotland, 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 2011. It is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

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

This is the final year of our appointment as auditors to NAS following the merger with the General Register Office for Scotland to form a new organisation called the National Records of Scotland (NRS). We would like to take this opportunity to record our appreciation for the kind assistance provided by the Keeper and the Accountable Officer and his staff during our audit and we wish NRS every success in the future.

Gary Devlin
for 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 2010-11 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. Our audit identified 18 separate adjustments to the draft accounts resulting in net operating expenditure increasing by £162,195. • It is disappointing to note that little progress was made by NAS during the year to improve financial reporting, management and monitoring arrangements. In particular, monthly budget statements and year end forecasts did not take account of non-cash accruals for early retirement costs, the impact of depreciation or the effect of additional shared service costs. NAS were not, therefore, in a position to forecast its year end outturn with any accuracy during the financial year. We anticipate that the merger with GROS will result in a significant improvement in overall financial control arrangements going forward.

Governance	
Merger with GROS to National Records of Scotland (NRS)	• We found that the operational arrangements to merge NAS with GROS to form National Records of Scotland (NRS) were good. Financial and budgeting arrangements are considered appropriate and are likely to improve as NRS staff gain more operating knowledge of NAS costs and income.

Overall governance	• We noted that NAS did not continue to hold Board or Audit Committee meetings from December 2010. This prevented non-executive Board members from having any significant involvement or oversight of merger arrangements. In our view this represented a significant loss of governance for the organisation as it prepared for the merger with GROS. • Our audit identified significant weaknesses in internal control arrangements. In particular, key reconciliations between the ledger and subsidiary systems (such as fixed assets and cash) did not take place regularly and control accounts were not reconciled or cleared at the financial year end. • We have raised, on numerous occasions, the need for NAS to retain adequate records to support the capitalisation of staff costs used in the 'digitisation of records' programme. The lack of any record keeping during the year required management to undertake additional work at the year end to provide audit with adequate assurance that these costs were fairly stated. We have received assurances that appropriate records will be retained going forward.

Performance and best value	
Best Value and Performance	• NAS did not have an effective Best Value framework in place during the year and key performance indicators were not fully aligned with the Corporate Plan. The creation of NRS presents a significant opportunity to review the performance management framework for the newly merged organisation and to ensure the Accountable Officer is better able to demonstrate compliance with the principles of best value.

2 Financial reporting

2.1 Net operating costs

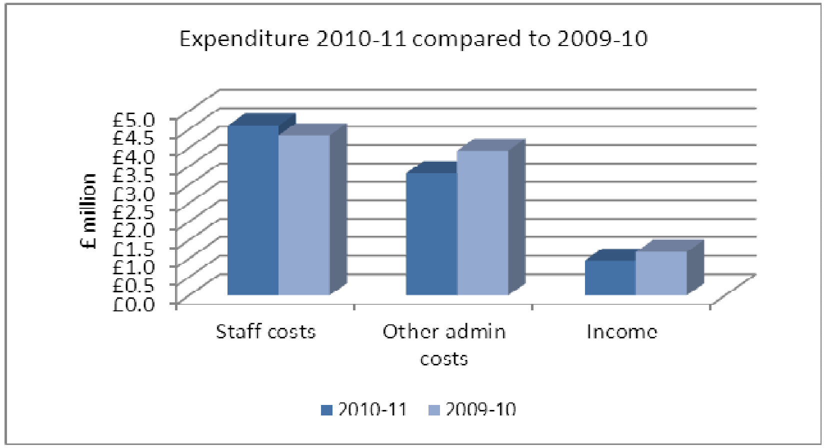
Summary statement of net expenditure	Actual 2010 (restated) £'000	Actual 2011 £'000	Budget 2011 (SBR) £'000
Staff Costs	4,340	4,521	4,572
Administration expenditure	3,924	3,522	3,629
Administration income	(1,180)	(946)	(700)
Transfer to capital budget	0	0	(250)
Total net expenditure	**7,084**	**7,097**	**7,251**

Comparison to budget:
In 2010-11, NAS's expenditure was within the regularity limit at £0.154million (2%) below its budget of £7.251 million.

This result has been achieved through:

- Administration expenditure £0.107 million favourable variance against budget arising primarily due to an underspend in supplies and services brought on by lower consumer demand.
- Administration income £0.246 million favourable variance against budget. Despite income being 19.8% down on 2009-10, demand has fallen at a lower rate than budget.
- Staff costs show a £0.051 million unfavourable variance against budget due to early retirement provision costs for 10 staff which were not included in the original budget. In addition the early retirement packages are determined by SG Central HR rather than NAS.
- Business archive grant £0.014 million favourable variance against budget. NAS have an arrangement with Business Archive Council Scotland (BACS) to meet 50% of their costs, up to a limit of £0.025 million. BACS recorded an underspend in the current year and thus the costs met by NAS were below the maximum commitment which was included in the budget.
- Staff costs have increased by £0.257 million due to increased early retirement costs for 10 staff in 2011 (2010: 2 staff).
- Following receipt of an unforeseen increase in income, agreement was reached with SG prior to the year end to transfer £0.250 million from the revenue to the capital budget in order to meet the costs of a large capital shelving project.

Comparison to 2009-10:
Net expenditure has increased by £0.013 million compared to 2009-10 (restated). Year on year movements include £0.229 million decrease in accommodation and fee income, £0.107 million decrease in administration expenditure, £0.014 decrease in grant expenditure and £0.181 million increase in staff costs.



2.2 Financial position

Balance sheet	2011 £'000	2010 £'000
Non current assets	16,839	14,824
Current assets	270	571
Current liabilities	(1,082)	(580)
Provisions for liabilities and charges	(282)	(90)
Total net assets	**15,745**	**14,725**
General fund	12,581	11,314
Revaluation reserve	2,449	2,634
Donated asset reserve	715	777
Total taxpayers' equity	**15,745**	**14,725**

Non current assets have increased by £2.015 million. Tangible additions were £1.135 million, disposals had a net book value of nil, depreciation of £0.797 million and a downwards revaluation of £0.085 million. Intangible additions were £1.710 million, disposals had a net book value of nil and amortisation of £0.024 million was charged. Tangible additions were mostly in respect of a major shelving project (£0.817million), a boiler upgrade (£0.120 million), general equipment (£0.106 million) and computer equipment (£0.092 million). Intangible additions include £1.071 million IT software and £0.639 million capitalised staff costs in relation to the ongoing digitisation project. The revaluation adjustment was in respect of the three buildings held by NAS and arose due to professional valuations being obtained as part of the 5 year rolling valuation programme.

Current assets at 31 March 2011 are £0.301 million less than at 31 March 2010. This is due to a reduction in trade debtors (£0.035 million) and the VAT debtor (£0.058 million) due to reduced consumer demand and the inclusion of £0.207 million non-recurring debtors in 2009-10.

Current liabilities at 31 March 2011 are £0.502 million higher than as at 31 March 2010. Trade creditors have decreased by £0.110 million with accruals and deferred income more than off-setting this with a significant increase of £0.612 million.

Provisions are in respect of NAS's liability for payments to people who have left under early retirement provisions which as previously noted has increased significantly in the year ended 31 March 2011. Audit adjustments have been proposed to correct the current disclosure of provisions.

The general fund has increased meaning that the cash funding requirement was higher than net expenditure.

General Fund	2011 £'000	2010 £'000
Balance at beginning of year	11,314	9,830
Non cash charges - auditor remuneration	63	65
Transfers between reserves	227	187
Net operating cost for the year	(7,097)	(7,084)
Net funding	8,074	8,316
Balance at 31 March 2010	**12,581**	**11,314**

The decrease in the revaluation reserve is in respect of the downwards revaluation on properties of £0.085 million offset by depreciation of £0.349 million.

The Donated asset reserve has decreased 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.

2.3 Conclusion

NAS is within the budget limits for both operating expenditure and capital expenditure. Following receipt of unanticipated income, it was agreed with the SG that it would be sensible to vire this extra resource to capital to allow the early completion of a large capital shelving project.

Going forward we suggest that the challenges for the newly merged body (National Records of Scotland) will be in controlling merger costs and developing accurate budgets and budget monitoring arrangements for the NAS side of the business.

3 Financial statements

Findings and conclusions

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 2010-11 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 and consider 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 we assess whether disclosures in the Statement are consistent with the information emerging from our normal audit work.

As part of our 2010-11 interim audit, we assessed the adequacy of NAS's financial systems in respect of:

- fixed assets
- purchasing
- budgetary control and monitoring procedures
- rehearsal for the year end financial statements close down procedures

We found that key financial systems are generally operating satisfactorily, however, some key controls were not fully operational during the year. In particular, controls over reconciliations between the ledger and subsidiary systems required improvement and budgetary control arrangements were weak.

We made five recommendations for improvements in our interim management report issued in March 2011. Four of these recommendations were considered high risk relating to the budget monitoring process, budget cover for early retirement costs, preparation for the final audit in the wake of the depleted finance team and the lack of formal Management Board and Audit Committee meetings. The remaining recommendation was considered medium risk relating to the reconciliation procedures between the fixed asset register and SEAS. Please refer to the interim report issued in March 2011 for our full conclusions.

The draft financial statements and supporting working papers were presented to the audit team broadly in line with the timetable. It was disappointing to note the documents supporting the financial statements were of a poor standard, resulting in significant additional work for the audit team to ensure sufficient evidence was available to fully support the disclosures within the accounts. A significant number of audit adjustments were required to be made to the draft accounts following our audit as a result at these are documented in Section 4 of this report.

Our audit has, however, now been completed, and we intend to give an unqualified opinion on both the financial statements of NAS for 2010-11 and on the regularity of transactions undertaken during the financial year.

3.1 Matters identified at the planning stage

Specific issue identified in our Audit Approach Memorandum	Auditor Response
Financial Statements for 2010-11 The draft financial statements were presented to the audit team with minor delay from the agreed timetable. It was however disappointing to note that on receipt and review several errors were identified .	We raised these issues on the first day of the audit fieldwork. The head of NAS finance and the Scottish Government accounting resource acknowledged their awareness of some of these errors and we agreed that the preferred course of action would be to collate all errors and update the financial statements when the audit was substantially complete. On review of the revised draft of the financial statements, many of the identified errors had not been corrected causing further delays in the audit process and accounts completion timetable.
Outturn to 31 March 2011 The NAS budget approved at the Spring Budget Revision (SBR) is for £10.2 million for both revenue and capital (split is £7.7 million revenue (including £0.2 million AMR), £2.5 million capital).	The outturn to 31 March 2011 is £0.158 million (2%) below its budget of £7.251 million. This is lower than the prior year underspend both in absolute terms and percentage underspend (2009:£0.327 million, 4.1%). There were several audit adjustments due to control weaknesses such as the fixed asset register not being up to date and accounting journals being mis-posted (early retirement provision part incorrectly posted and part omitted). These errors undermine the budget monitoring activity being performed at NAS and make budget monitoring unpredictable. A full list of the audit adjustments is noted at Section 4.

Specific issue identified in our Audit Approach Memorandum	Auditor Response
Capitalisation of staff costs NAS have in place a policy of capitalising an element of staff costs that relates directly to the digitisation of records. The calculation performed by management is inherently judgemental. We requested in our Audit Approach Memorandum that NAS management provide us with a sample of staff timesheets to back up the calculation. An initial meeting with NAS management at the outset of the audit fieldwork revealed that no timesheets were available as audit evidence.	Total staff costs capitalised this year are £0.639 million (2009: £0.622 million) representing a significant audit balance. NAS management were unable to provide staff timesheets to support the calculation. We reviewed the calculation to ensure it appeared reasonable in line with the 2009-10 calculation. We requested further evidence from NAS management to gain sufficient comfort over this balance and confirmed that underlying activity supported the year end position. Our audit procedures identified errors in the calculation resulting in a £53k over capitalisation of staff costs. An audit adjustment has been proposed to correct the error. We discussed the policy of capitalising staff costs with the Accountable Officer of NRS and agreed that going forward additional evidence would be retained to support future capitalisation of staff costs.

3.2 Matters identified during the audit

Matter	Conclusion
Non current assets Errors were identified from our review of the non-current asset register. Heritage assets totaling £0.800 million which were originally lottery funded were identified in the 2009-10 audit as being incorrectly treated as non-depreciating. We amended this position in the 2009-10 accounts and advised NAS management the non-current asset register required to be updated to reflect the depreciation rate and charge to date. Our audit work this year highlighted the amendments have not been made to the asset register resulting in a £nil depreciation charge being recorded for the asset in the year to 31 March 2011. An amount equivalent to the depreciation charge for a similar heritage asset was subsequently incorrectly released from the donated asset reserve to the operating cost statement.	We have calculated the correct depreciation charge for 2010-11 for the £0.800 million asset and noted this on our list of audit adjustments. We have discussed the issue with the Accountable Officer of NRS and advised the corrective action required to the non-current asset register going forward. We recommend the impact to the donated asset reserve by releasing an amount equivalent to the depreciation charge on the similar heritage asset is reversed. We note additional audit time was spent on this issue as a result of failure of NAS management to maintain the FAR up to date. In particular, closing 2009-10 audit journals have not been posted to the FAR.

Brought forward balances between the 2009-10 accounts and the non-current asset register did not agree. We understand this is due to Britannia not being maintained up-to-date and specifically 2009-10 closing audit journals not being posted to the asset register.	The largest variance in opening balances between Britannia and SEAS identified totalled £0.017 million was in relation to the brought forward digitised images balance. We have recommend this balance is written off in the current year unless NAS management can provide information on the origin of the variance.
During our additions testing we identified an incorrect allocation between tangible and intangible additions resulting in an overstatement of intangible assets cost of £0.259 million.	We have discussed the allocation of additions with NAS management who concur that an adjustment is required to the accounts. The adjustment can be seen on our list of audit adjustments at Section 4.
We further identified that incorrect depreciation/ amortisation has been charged on tangible and intangible assets. The draft 2010-11 accounts are inconsistent showing a £nil amortisation charge for digitised images and an accounting policy of amortising the asset over 60 years.	We have spent considerable audit effort reviewing the non-current asset register resulting in identification of the element of intangible amortisation which has been incorrectly disclosed as tangible depreciation. Four separate adjustments totalling £63k has been included on our audit adjustment list to correct this disclosure. We further note the cause of this error is due to tangible and intangible IT assets being included in one category on the asset register. We recommend management update the asset register to ensure tangible and intangible IT assets are categorised separately.
Matter	**Conclusion**
There were other discrepancies noted from review of the FAR such as asset SRO2000/170/32/2 totaling £0.010 million being included on the asset register and not on the valuation report and the new shelving asset totaling £0.817 million being included within fixtures and fittings with a depreciation rate of 20 years which is inconsistent with the accounting policy disclosed in the accounts.	The impact of these errors is immaterial to the audit however we recommend management undertake a detailed review of the asset register to ensure it is maintained up to date. In addition, these errors strengthen the need to implement a control of reconciling Britannia and SEAS on a monthly basis. At present, only additions are reconciled monthly between Britania and SEAS.
Early departure provision NAS require to make provision in their accounts for future costs of employees who have opted to take early retirement. In 2009-10 this provision was made up of costs relating to two employees who retired in 2008. In the year to 31 March 2011, a further 10 employees took early retirement, with a further 9 due to retire by June 2011 therefore we would expect to see an increase in the early retirement provision at 31 March 2011.	From review of the ledger there has been no movement to the early retirement provision in the year to 31 March 2011. We reviewed journals processed by NAS management in the year relating to early retirement costs and also reviewed documentation from the Scottish Government which stipulates early retirement costs incurred by NAS. From this review we identified accounting errors resulting in a net £0.192 million understatement of both retirement costs and the early retirement provision. We have noted

We would also expect early retirement costs charged to the operating cost statement to be higher in 2010-11 compared to 2009-10.	the required adjustments on the list of audit adjustments.
Holiday pay accrual Under the IFRS framework NAS are required to make an accrual for staff holiday costs. From review of the 2010-11 holiday accrual, NAS have calculated this consistently with the 2009-10 accrual however there have been basic errors made in reversing the 2009-10 accrual resulting in a misstatement of the general fund and outturn for the year.	We have added an adjustment to the list of audit adjustments to reduce the net funding and decrease the salary cost by £0.114 million. This realigns net funding to £8.074 million which agrees to the Agency Funding return submitted to the Scottish Government.

Matter	Conclusion
Recharge of staff costs from GROS A recharge of £0.229 million has been processed as an expense in the 2010-11 accounts. £0.208 million of this has been processed as salary costs with the remaining £0.021 million being processed as maintenance contract costs.	We have reviewed the reason for the recharge of staff costs and consider this reasonable. We reviewed the calculation for the recharge and agreed this as calculated correctly. We reviewed the disclosure of the recharge and consider the element categorised as salary costs to be incorrectly disclosed. GROS have already accounted for this as a salary costs and therefore NAS should account for the recharge as an expense other than salaries. The creditor balance will be eliminated on 1 April 2011 when the bodies merge.
AP control account No backup was provided to support this creditor balance in the original audit file prepared by NAS management. The audit team requested a detailed creditor listing on several occasions throughout the audit fieldwork. NAS management subsequently provided a full listing of all debit and credit transactions processed through this account, however this was not sufficiently detailed to test the balance.	Considerable audit time was spent trying to obtain backup for the AP control account. John Ferguson (GROS) was subsequently contacted to obtain the detailed creditor report. No issues were noted with the balance when tested. We recommend NAS staff receive appropriate training to provide them with the requisite knowledge to generate key financial information.
NAS commercial creditor No audit evidence has been received for the commercial creditor balance totalling £0.051 million. From discussions with NAS management we understand this account is a holding account where all SPC till receipts are allocated prior to them being split between the partners. The account should therefore be reconciled to £nil on a monthly basis. Current controls around reconciling this account appear weak.	Discussions have been held with NAS management and the NRS Accountable Officer regarding this account balance. We have been unable to obtain any audit evidence to support the balance. The balance appears to represent a core £51k that has not moved since the prior year and therefore we have proposed to write off this balance when merging the NAS and GROS balances sheets. Controls over this account need to be improved going forward. The creditor operates as a control account and therefore the balance should be reconciled to £nil on a monthly basis. Implementation of this control should be taken forward within the new body NRS.

Matter	Conclusion
BT cost provision During our creditor testing, we noted an accrual for BT costs totalling £40k, which relates to a disputed claim from BT for payment of costs relating to Support Services. The dispute centres around the non renewal of the Maintenance Support Contract by NAS management in December 2007 and subsequent continued use of the RAC search tool. BT are seeking legal advice on the matter as according to the contract entitlement, use of the RAC search tool is dependent on a current Support Services contract. Current case law appears to be in BT's favour and therefore NAS have created an accrual for the costs on this basis.	We concur with the recognition of the provision in the 2010-11 accounts as Case Law appears to be against NAS and therefore it is probable that the costs are payable.

4 Audit adjustments

4.1 Adjusted items

The audit identified a significant number of adjustments to the draft accounts with an aggregate increase in cost of £162k as detailed below:

	Detail of Adjustment	Adjustments Made to the Accounts					
		Balance Sheet					Operating Cost Statement
		CA	NCA	CL	NCL	SE	
1	DR FA accum depreciation (buildings)		347,000				
	CR Revaluation reserve					(347,000)	
	being revaluation reserve correction						
2	DR Tangible ICT additions		258,930				
	CR IFA digitised images additions		(258,930)				
	being reallocation of tangible additions currently disclosed as intangible additions						
3	DR FA (ICT Systems) accum depreciation		53,513				
	CR IFA (digitised images) accum amortisation		(53,513)				
	being reallocation of digitised images amortisation charge for the year from ICT FA depreciation charge.						
4	DR IFA (digitised images) accum amortisation		2,000				
	CR Amortisation (OCS)						(2,000)
	being adjustment required to realign b/f amortisation of digitised images in the accounts with the b/f amortisation on the FAR						
5	DR Fixed assets (ICT Systems) accumulate depreciation		4,662				
	CR IFA (digitised images) accumulate amortisation		(4,662)				
	being reallocation of staff cost additions amortisation charge from ICT FA accumulated depreciation code.						
6	DR Fixed assets (ICT Systems) accumulate depreciation		6,346				
	CR IFA (digitised images) accumulate amortisation		(6,346)				
	being reallocation of data conversion additions amortisation charge from ICT FA accumulated depreciation code.						

	Detail of Adjustment	Adjustments Made to the Accounts					
		Balance Sheet					Operating Cost Statement
		CA	NCA	CL	NCL	SE	
1	DR FA accum depreciation (buildings)		347,000				
	CR Revaluation reserve					(347,000)	
	being revaluation reserve correction						
2	DR Tangible ICT additions		258,930				
	CR IFA digitised images additions		(258,930)				
	being reallocation of tangible additions currently disclosed as intangible additions						
3	DR FA (ICT Systems) accum depreciation		53,513				
	CR IFA (digitised images) accum amortisation		(53,513)				
	being reallocation of digitised images amortisation charge for the year from ICT FA						
4	DR IFA (digitised images) accum amortisation		2,000				
	CR Amortisation (OCS)						(2,000)
	being adjustment required to realign b/f amortisation of digitised images in the						
5	DR Fixed assets (ICT Systems) accumulate depreciation		4,662				
	CR IFA (digitised images) accumulate amortisation		(4,662)				
	being reallocation of staff cost additions amortisation charge from ICT FA						
6	DR Fixed assets (ICT Systems) accumulate depreciation		6,346				
	CR IFA (digitised images) accumulate amortisation		(6,346)				
	being reallocation of data conversion additions amortisation charge from ICT FA						
13	DR Early departure provision (BS)				10,457		
	CR Early retirement costs (OCS)						(10,457)
	being reduction in provision to bring opening provision in line with the balance per the spreadsheet provided by SG.						

	Detail of Adjustment	Adjustments Made to the Accounts					
		Balance Sheet					Operating Cost Statement
14	DR Early retirement costs (OCS)						217,090
	CR Early departure provision				(217,090)		
	being increase to provision for pension costs from 2011/12 to 2018/19 for 7 staff who retred in 2010/11.						
15	DR Prepayments & Accrued income	38,918					
	CR Sundry debtors	(38,918)					
	being reallocation of accrued income to disclose balance correctly and consistently with PY.						
16	DR Maintenance contracts (Supplies & services) (OCS)						207,764
	CR Salary costs (OCS)						(207,764)
	being reallocation of recharged GROS staff costs from salary cost to general cost.						
17	DR Staff costs (OCS)						52,963
	CR Capitalised staff costs		(52,963)				
	being reduction required due to October estimate not being reversed.						
	Accounts Impact	**-**	**645,037**	**-**	**(206,633)**	**(694,000)**	**255,596**

Previous adjusted items 7 to 12 have been replaced with a duplication of adjusted items 1 to 6? Items 7 to 12 to be reinstated.

Also new adjusted items to be included in above table for the following:-

- Address shortfall in depreciation charge through previous roundings for depreciation adjustments:- £3,699.07 - Dr Dep'n (OCS), Cr TFA Dep'n
- Revalue downwards 2 assets that were omitted from revaluation of land & buildings:- £84,979.56 - Dr Rev Res, Cr FA Rev Res
- Transfer Rev Res (realised element) to General Fund (omission):- £266,998.48 - Dr Rev Res, Cr General Fund
- Re-align assets between TFAs and IFAs:- £379,229.15 - Dr IFA, Cr TFA

4.2 Unadjusted items

There are 3 unadjusted difference to report with none regarded as material in the context of NAS's overall expenditure.

	Detail of Adjustment	Adjustments Made to the Accounts					
		Balance Sheet					Operating Cost Statement
1	DR Capitalised staff costs		4,016				
	CR Staff costs (OCS)						(4,016)
	being increase due to difference between March 2011 capitalised cost backup and amount capitalised.						
2	DR Accruals			1,200			
	CR Admin expenses						(1,200)
	being reversal of post year end expense accrued.						
3	DR Accruals			51,000			
	CR Admin expenses						(51,000)
	being reversal of commercial creditor balance carried forward from prior year						

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 2010-11 interim audit, we assessed the adequacy of NAS's governance arrangements against good practice standards for the public sector in respect of the amalgamation process with GROS.

We noted that overall the planning arrangements for the merger were good, in particular, the formation of various working group to address key aspects of the merger. Our only recommendation at the interim stage related to setting dates in advance and adhering to these dates for formal NAS Management Board meetings and Audit Committee meetings. It was our finding that these meetings had slipped to being held on an ad hoc basis from late 2010.

The following table sets out additional matters covered during our audit of the 2010-11 financial statements.

5.3 Matters identified at the planning stage

Specific issue identified in our Audit Approach Memorandum	Auditor Response
Amalgamation & Budget 2011-12 NAS merged with GROS into a new body 'National Records of Scotland' (NRS) on 1 April 2011. In our Audit Approach Memorandum we identified the key risk areas as Governance and Financial. Within the Governance risks we identified the need to ensure effective project management, effective risk management, effective governance, alignment of strategies, integration of staff, effective management of distraction from day to day activities, effective cost reduction processes (workforce planning and asset management) and setting an effective budget for the new body.	At our interim audit we reviewed the plans for the merger. We noted from our review that the planning for the merger was good with various working groups set up to analyse the issues and report back to central management. At our final audit we reviewed the budgetary plans for the new body and the finance arrangements. We noted that the creation of a new chart of accounts and monitoring reports has been developed by adding codes to the existing GROS structure. Therefore budget holders have been able to review their spending easily.

Specific issue identified in our Audit Approach Memorandum	Auditor Response
Within the Finance risks we identified that the NAS and GROS closing balances should be properly stated to ensure opening balances in the new body are correct, accounting policies in both bodies should be reviewed and aligned, intercompany balances between NAS and GROS at the year end should agree to enable simple cancelling of these balances in the new body and asset valuations should be updated/carried out in both bodies to ensure the fair values assigned to assets in the new body are accurate.	The development of a budget for the new body NRS was completed in mid June 2011. While this is a delay of two and half months following the merger, the budget that has now drawn up should be of higher quality than a simple add together of the existing 2011-12 budgets for NAS and GROS. In particular there have been significant staffing changes in Corporate Services which have been reflected in the new budget. We understand that the budget will be formally accepted at ABR and any adjustments put through at SBR in due course. In particular the previous NAS departmental budgets will be closely monitored and changes are considered more likely as there has been less available historical and monitoring information to allow these budgets to be compiled.
Accountable Officer NAS's Accountable Officer opted to take early retirement effective from 31 March 2011. Provisions require to be put in place for the signing of the 2010-11 NAS accounts following the departure of the Accountable Officer. It is our understanding that arrangements are being made for the Accountable Officer of the new merged body NRS to be able to sign the 2010-11 NAS accounts.	The Accountable Officer of NRS has been granted the appropriate permission to sign the 2010-11 NAS accounts. We have maintained contact with the NRS Accountable Officer throughout the audit process and concur this officer has sufficient knowledge of NAS to sign off on governance and financial management.

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 2014-15. In many areas this means that current levels of service provision may be 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.

As part of our final 2010-11 audit carried out in June2011, we reviewed NAS's arrangements for:

- ensuring Best Value
- delivering efficiencies.

The following table sets out additional matters covered during our audit of the 2010-11 financial statements.

Specific issue identified in our Audit Approach Memorandum	Auditor Response
Audit Scotland Audit Scotland requires auditors to provide feedback twice a year to them on the response by NAS to national performance reports that are relevant to 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 the relevant recommendations, we are required to discuss this with you and include a recommendation within our reports to you. In addition, for 2010-11 we are required to examine in more detail the response to some national performance reports, in particular "Improving Public Sector Purchasing".	We have reviewed the latest procurement capability assessment (PCA) report assessing the efficiency of procurement at NAS and note NAS were given a non-conformance rating by the SG. Several recommendations were made to NAS to improve this rating however we are not aware of any of these recommendations having been implemented. We recommend that the newly merged body NRS review procurement practices within the NAS division with a view to strengthening current practices and conforming with SG best practice. From our discussions with Sue Barber, Head of Procurement, we understand that work is on-going to develop an improvement plan for the new body NRS. We have reviewed the body's response to national reports on Energy Efficiency and the Role of Boards and consider that these have been considered appropriately: energy efficiency improvement plans are being formulated for the new body NRS and a board has been put in place in the new body.

Specific issue identified in our Audit Approach Memorandum	Auditor Response
Performance In 2009-10 we concluded that NAS is good at working in partnership with others and has developed several strong relationships with a number of other partner organisations. We however noted that NAS's performance management framework required further development to ensure that key performance indicators are more meaningful and measurable and in line with corporate plan objectives Best value principles also needed to be integrated more clearly into corporate planning and management arrangements and supported by an action plan with responsibilities for actions assigned to a specific individual.	We reviewed NAS's key performance indicators (KPIs) for the year to 31 March 2011. From this review we note that KPIs are in place at NAS however there is no evidence that these are effectively monitored by management. We recommend that KPI's are reviewed going forward by the newly merged body NRS. Specifically KPI's appropriate to the Key Business Objectives (KBOs)) of NRS should be developed and these should be measurable and reported to key management on a timely basis.
Efficiency savings The Scottish Government has set NAS a target to achieve £0.158 million in efficiency savings each year from 2008-09 to 2010-11. NAS achieved this target in 2008-09 and 2009-10 largely through reductions in staff costs through not replacing employees who leave.	We have reviewed the Efficiency Return for 2010-11 which states that NAS has exceeded its target efficiency savings of £0.158 million by £0.094 million. Efficiencies of £0.252 million have been achieved mainly through improvements in asset management (£0.132 million) and procurement (£0.120 million) with £0.062 million of the total being non-recurring. This area should continue to be monitored by NRS management going forward post merger.

7 Looking forward

NAS merged with GROS on 1 April 2011 to form a new body 'National Records of Scotland' (NRS). The bodies already worked closely together and so the merger should continue these positive relationships between the divisions of the NAS and GROS while saving on support costs.

The merged body has been progressing the merging of IT systems and finance systems during the busy Census period for GROS. The management have taken the opportunity to take a strategic and critical review of the existing performance targets and measures, objectives and reporting as well as efficiencies and savings. This has resulted in a budget process which has concluded in June 2011, which should provide a realistic budget for the new merged organisation.

Planning for the public sector funding cuts of 15-20% over the three years from April 2011 will also need to remain as a key planning priority. The challenge for NRS will be to control spending and make efficiencies in the same way as previously in the bigger body, while aiming to be on target. Budgetary planning in the next few years is likely to be an improving process as NRS gets to grips with the two previous organisations spending.

8 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, the Keeper of the Records of Scotland (the Keeper) 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 2011.

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 Keeper, the Accountable Officer and auditors

The Accountable Officer is 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 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	59,290
Audit Scotland fixed charge	4,200
Total	63,490