

National Galleries of Scotland

Annual report on the 2010/11 audit



Prepared for National Galleries of Scotland and the Auditor General for Scotland
November 2011

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Key messages

2010/11

We have given an unqualified opinion on the financial statements of NGS for 2010/11. NGS' net asset position increased to £312.149 million (2009/10 £285.564 million) mainly due to expenditure on the Portrait of a Nation building project and payment of creditors for the purchase of Titian's *Diana and Actaeon*.

NGS is required to work within the budget set by the Scottish Government. NGS overspent the non-cash part of its budget of £25.983 million in 2010/11 by £0.186 million due to an overspend in depreciation.

Within its published accounts for 2010/11 NGS recorded an excess of expenditure over income transferred to reserves of £9.650 million. The 2010/11 voluntary severance exercise resulted in three staff leaving the organisation at a cost of £107,000. Details are disclosed in the financial statements.

NGS is working with the National Library of Scotland on developing shared services for corporate support activities. A shared finance system has been delivered and major progress made on integrating the technical infrastructures, which will enable further shared service developments. A shared services programme board and a governance group are in place and the HR teams are working together under the direction of an Interim Head of Organisational Development.

NGS is required to make two per cent efficiency savings each year over the three years to 2010/11 and a further one per cent in 2010/11. NGS reported achieving 2010/11 savings of £1.507 million.

Outlook

A 6.34% (£0.813 million) reduction in the operating cost budget represents a significant challenge to NGS. NGS is realigning their business model to adapt to reduced support from Scottish Government through continuing with efficiency measures and looking for a wider range of income streams. This enabled NGS to set a balanced budget for 2011/12. NGS published a new corporate plan for 2011-14 which sets out the vision for the future whilst taking into account the challenges presented by the present economic environment. A new trading company has been formed with effect from 2011/12.

Introduction

1. This report is the summary of our findings arising from the 2010/11 audit of National Galleries of Scotland (NGS). The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.
2. Reports have been issued in the course of the year (Appendix A) and we do not repeat all of the findings in this report, but instead we focus on the financial statements.
3. This report is addressed to NGS and the Auditor General and should form a key part of discussions with audit committees, either prior to or as soon as possible after the formal completion of the audit of the financial statements. Reports should be made available to stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.
4. This report will be published on our website after consideration by NGS.
5. The management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to our attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

6. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
7. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
 - the regularity of the expenditure and income (except for local government bodies).
8. Auditors review and report on, as appropriate, other information published with the financial statements, including the management commentary, statement on internal control and the remuneration report. Where required, auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit on the financial statements.

Audit opinion

9. We have given an unqualified opinion that the financial statements of NGS for 2010/11 give a true and fair view of the state of the body's affairs and of its incoming resources and application of resources, including its income and expenditure for the year.
10. NGS is required to follow the 2010/11 Government Financial Reporting Manual (the FReM) and we confirm that financial statements have been properly prepared in accordance with the FReM.

Regularity

11. In accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000 we have also provided an opinion, that in all material respects, the expenditure and receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

Remuneration report and statement on internal control

12. In our opinion, the audited part of the remuneration report has been properly prepared and is consistent with the financial statements.
13. We also confirm that we have no issues to report to you on the statement of internal control and its compliance with Scottish Government guidance.

Accounting issues

Accounts submission

14. The financial statements were submitted for audit on 16 June, in accordance with a pre-agreed timetable. The audit fieldwork was completed on 21 July and matters arising from this work were reported to the Head of Finance and IT on 3 August. A revised account incorporating heritage asset disclosures and the inclusion of the severance scheme was submitted for audit on 5 September. A report covering any significant matters on the financial statements was issued on 13 September for the Audit Committee on 28 September. The revised financial statements were signed by the Director General and accountable officer following approval by the board on 10 October.

Presentational and monetary adjustments to the unaudited accounts

15. A number of presentational changes were required to the annual report and accounts as a result of our review of the disclosures required by the FReM and a monetary adjustment was required for the provision for voluntary early exits. The audited financial statements have been adjusted to reflect these issues.

Prior year adjustments

16. All central government bodies have been affected by the removal of the cost of capital in the 2010/11 FReM and some including NGS by the change in disclosure of heritage assets. These changes are identified in Note 1 as changes in accounting policy and appropriate amendments have been made to the prior year statements.

Whole of government accounts/ consolidation packs

17. The whole of government accounts (WGA) is the consolidated financial statements for all branches of government in the UK. NGS was required to submit a consolidation pack to the Scottish Government, prior to the submission to audit by 15 July. The pack was submitted on 2 August, there was a delay in uploading the pack to the WGA accounting system (COINS) and the audit is currently being completed.

Outlook

18. The main change in the financial reporting framework (FReM) next year (2011/12) is that grants and donated assets should be recognised immediately, unless there is a condition that the recipient had not satisfied that would lead to repayment. Most grants and donated assets should be recognised as income, but grants from a sponsoring department to an NDPB should be credited to general reserves. As a consequence, the government grant reserve and donated asset reserve will no longer exist. This is likely to result in a presentational change to the financial statements of NGS next year.

International financial reporting standards (IFRS)

19. 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 NGS, 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 NGS 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.

Audit appointment for 2011/12

20. Audit appointments are made by the Auditor General, either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment. The procurement process for the next five years was completed in May 2011. From next year (2011/12) the auditor for NGS will be PricewaterhouseCoopers. As this is the last year of our audit appointment, we would like to acknowledge the good working relationship that existed during our current appointment term with NGS and thank staff and members of the board and committees for their assistance during the last five years. We will be meeting the incoming external auditors, PricewaterhouseCoopers, as part of a managed changeover process.

Financial position

21. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
22. Auditors consider whether audited bodies have established adequate arrangements and examine:
 - financial performance in the period under audit
 - compliance with any statutory financial requirements and financial targets
 - ability to meet known or contingent, statutory and other financial obligations
 - responses to developments which may have an impact on the financial position
 - financial plans for future periods.
23. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results 2010/11

24. The Scottish Government provides NGS with a budget and cash allocation for the year, which originates from the spending review settlement and is subsequently approved in the budget bill. During the year revisions are approved in the autumn and spring budget revisions. NGS is expected to manage its budget in accordance with its financial memorandum document and Scottish Public Finance Manual.
25. The total grant in aid offered by the Scottish Government for NGS for 2010/11 was £25.983 million. This figure comprises an operating budget of £12.808 million, purchase grant of £1.86 million, capital budget of £9.515 million and non-cash items of £1.8 million. In 2010/11 NGS drew down its full cash grant in aid entitlement and overspent the budget limits set by the Scottish Government by £0.186 million due to an overspend in depreciation (non-cash) – see exhibit 1 below.

Exhibit 1 – Performance against budget 2010/11 (£ million)

Limits	Grant in Aid offer	Actual Outturn	Difference
Cash items			
Operating costs	12.808	12.808	Nil
Purchase grant	1.860	1.860	Nil
Capital including major projects	9.515	9.515	Nil
Non-cash items			
Depreciation	1.800	1.986	(0.186)

Limits	Grant in Aid offer	Actual Outturn	Difference
Total	25.983	26.169	(0.186)

Source: NGS 2010/11 annual report and accounts

26. NGS is required taking one year with another, to meet the Scottish Government resource limits set for it. Although we note the in-year overspend above, confirmation has been received from Scottish Government that this overspend would be managed by them.
27. The FReM requirement to account for grant in aid as a credit to reserves has resulted in an excess of expenditure over income transferred to reserves of £9.650 million (2009/10 £11.619 million). The decrease of £1.969 million was due mainly to an increase in income from loans of artworks, donations and trading activities, partly offset by an increase in expenditure on a voluntary early exit scheme.

Financial position at 31 March 2011

28. NGS' net asset position increased to £312.149 million (2009/10 £285.564 million) mainly due to expenditure on the Portrait of a Nation building project and payment of creditors for the purchase of Titian's *Diana and Actaeon*.

Budgetary control

29. NGS has sound budget setting and monitoring arrangements. Initiatives in 2010/11 to control expenditure included a voluntary early exit scheme, procurement efficiencies and strict enforcement of departmental budgets.

Capital investment and performance 2010/11

30. NGS invested £9 million in the Portrait of a Nation building project for The Scottish National Portrait Gallery which is due to re-open to the public in November 2011 and acquired items for the gallery collections worth £3 million. NGS reported that the completion of the project is on target and within budget.

Financial planning to support priority setting and cost reductions

31. A number of initiatives have been introduced to enable NGS meet the budget reductions applied for the current and future years. In 2010/11, due to the difficult financial climate and impending reduction in grant in aid, the Director-General established a sub-group of the Senior Management Team to develop a more sustainable business model.

Workforce reduction

32. A voluntary early exit scheme was introduced in 2010/11 and the scheme was approved by the Scottish Government. The scheme will cost £107,000 over a number of years and has seen the departure of three staff. Recruitment restrictions resulted in a further reduction of the workforce through natural attrition.

Partnership working

33. NGS is working with the National Library of Scotland on developing shared services to improve the effectiveness of IT, HR and Finance functions. The project to share the NGS finance system with National Library of Scotland went live on 1 April 2011, and major progress has been made on integrating the technical infrastructures which will enable further shared service developments. A shared services programme board and a governance group are in place and the HR teams are working together under the direction of an Interim Head of Organisational Development.
34. NGS continues to develop useful and mutually beneficial relationships with museums and galleries both within the UK and abroad, enhancing access to artworks from the collection and enabling access to works from other regions and countries.

Outlook

2011/12 budget

35. Scottish Ministers have agreed a financial allocation of £15.310 million for 2011/12. This comprises operating expenditure of £11.995 million, capital expenditure of £1.615 million and non-cash expenditure of £1.700 million. The operating costs allocation is a significant reduction of £0.813 million (6.34%) from the previous year. NGS is realigning its business model to adapt to reduced support from Scottish Government through continuing with efficiency measures and looking for a wider range of income streams. This enabled NGS to set a balanced budget for 2011/12.

End Year Flexibility

36. As part of efforts to reduce national borrowing levels, the UK Government has announced the replacement of End Year Flexibility with a more restrictive Budget Exchange arrangement from 2011/12. The Scottish Government is in dialogue with HM Treasury about the ultimate implications for the Scottish Budget, including the extent to which it can carry forward any unspent funding from 2010/11 to future years.

Governance and accountability

37. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
38. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.
39. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
 - corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption.
40. In this part of the report we comment on key areas of governance.

Corporate governance

Processes and committees

41. The Director General is supported by a Board of Trustees which is responsible for ensuring that NGS fulfils the aims and objectives set by Scottish Ministers. The role of the Board includes establishing the overall strategic direction, monitoring performance against agreed objectives and ensuring that statutory requirements for the use of public funds are complied with.
42. NGS has an Audit and Risk Committee which monitors and reviews risk, control and corporate governance and reports to the Board.

Internal control

43. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, our wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.
44. Our audit approach includes a review of the high level controls operating within NGS' key financial systems. Our overall conclusion from the 2010/11 review was that key controls were operating effectively and that NGS has adequate systems of internal control in place.

45. In the interests of an efficient audit approach we rely on the work of Baker Tilly, the internal auditor. Baker Tilly carried out a review of the transfer of trading activities including stock valuation policies from NGS to its newly established trading subsidiary, NGS Trading Company Limited, at 1 April 2011 and we have relied on this. In their annual report for 2010/11, Baker Tilly provided their opinion that based on the internal audit work undertaken during the year, NGS has an adequate framework of control over the systems examined.
46. The statement on internal control within the 2010/11 financial statements accurately reflects the findings of internal and external audit work.

Prevention and detection of fraud and irregularities

47. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Auditors review and report on these arrangements. NGS has detailed policies and codes of conduct for staff and Board members covering gifts and hospitality.

Standards of conduct and arrangements for the prevention/detection of bribery and corruption

48. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. We have concluded that the arrangements in NGS are satisfactory and we are not aware of any specific issues that we need to identify in this report.

Best Value, use of resources and performance

49. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.
50. As part of their statutory responsibilities, the Auditor General and the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:
 - a performance audit which may result in the publication of a national report
 - an examination of the implications of a particular topic or performance audit for an audited body at local level
 - a review of a body's response to national recommendations.
51. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments.
52. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.

Management arrangements

Best Value

53. In March 2011, the Scottish Government issued new guidance for accountable officers on Best Value in Public Services. The new guidance, in essence, required public bodies to take a systematic approach to self-evaluation and continuous improvement.
54. The guidance identifies the themes which an organisation needs to focus on in order to deliver the duty of Best Value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.
55. The five themes and two cross-cutting themes (some of which we have commented on earlier in this report) are:
 - vision and leadership
 - effective partnership
 - governance and accountability
 - use of resources
 - performance management
 - equality (cross-cutting)

- sustainability (cross-cutting).
56. In responding to budget reductions for future years NGS is considering best value guidance to ensure sound principles are followed.

Overview of performance in 2010/11

Key performance indicators

57. The main aims of NGS are to
- To develop a sustainable and efficient business model to support our aims and ensure long-term viability
 - To use the national collection to inform and inspire the public and to encourage artistic excellence, innovation and creativity
 - To increase access, encourage participation and promote learning.
58. To help measure its performance in 2010/11 NGS set itself key performance targets. Some targets and reported achievements were:
- the target of digitising 2,900 on-line collections works was exceeded by 29
 - the total number of paying visitors to paying exhibitions exceeded the target of 132,500 by 2,000.
59. In the current three year budget settlement NGS is required to make two per cent efficiency savings each year over the three years to 2010/11 and a further one per cent in 2010/11. NGS reported 2010/11 savings of £1.507 million

National performance reports

60. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland.
61. Reports in the last year of direct interest are set out in Exhibit 2.

Exhibit 2: A selection of National performance reports 2010/11

- | | |
|---|---|
| <ul style="list-style-type: none"> • Improving energy efficiency: a follow-up report • Scotland's public finances: responding to the challenges | <ul style="list-style-type: none"> • The role of boards • Role of boards: a summary for non-executive board members • The cost of public sector pensions in Scotland |
|---|---|

Source: www.audit-scotland.gov.uk

The role of boards

62. The report noted that there remains a lack of clarity about the roles of the boards of public bodies, particularly the extent to which they provide leadership and strategic direction and examines this issue, along with other questions about the work of boards. The NGS Board Review Committee discussed the Role of Boards report at its meeting in November 2010.

Improving energy efficiency: a follow-up report

63. Scotland has ambitious targets to reduce greenhouse gas emissions and public bodies are adopting a more strategic approach to improving energy efficiency. However, the public sector as a whole is not yet reducing emissions at sufficient pace to set a good example or influence others, and future budget reductions may affect the level of investment available to achieve further improvement. NGS monitors CO₂ emissions and water consumption and has installed a new building management system to achieve energy savings.

Outlook

64. NGS published a new corporate plan for 2011-14 which sets out the vision for the future whilst taking into account the challenges presented by the present economic environment. NGS is undertaking a major review of the business with the aim of finding more efficient ways of delivering services and reducing expenditure, whilst retaining the quality of the programme. A trading company has been formed with effect from 2011/12. The company will focus on developing the commercial income stream. NGS will need to prepare consolidated financial statements for 2011/12.

Appendix A: audit reports

External audit reports and audit opinions issued for 2010/11

Title of report or opinion	Date of issue	Date presented to Audit Committee
Annual Audit Plan – NGS	21 February 2011	23 February 2011
Key financial controls assurance report	3 May 2011	24 May 2011
Report on financial statements to those charged with governance	13 September 2011	28 September 2011
Audit opinion on the 2010/11 financial statements	13 September 2011	28 September 2011