
National Library of Scotland

Annual Report to Those Charged
with Governance and the Auditor
General for Scotland

Year ended 31 March 2015

10 August 2015

PricewaterhouseCoopers
141 Bothwell Street
Glasgow
G2 7EQ

The Audit Committee
National Library of Scotland,
312-320 Lawnmarket
Edinburgh
EH1 2PJ

10 August 2015

Ladies and Gentleman,

We are pleased to enclose our report to the Audit Committee in respect of our audit for the year ended 31 March 2015. The primary purpose of this report is to communicate the significant findings arising from our audit that we believe are relevant to those charged with governance.

The scope and proposed focus of our audit work was summarised in our audit plan, which we presented to the Audit Committee in February 2015. We have subsequently reviewed our audit plan and concluded that our original risk assessment remains appropriate. The procedures we have performed in response to our assessment of significant audit risks are detailed in Section 2.

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion on the financial statements on 21st September 2015. At the time of writing, the key outstanding matters, where our work has commenced but is not yet finalised, are completion of subsequent events review and receipt of the signed letter of representation from Management. We will provide an oral update on these matters at the meeting on 10 August 2015.

We look forward to discussing our report with you on 10 August 2015. Attending the meeting from PwC will be James Gray and Jennifer Bell.

Yours faithfully

PricewaterhouseCoopers LLP

Contents

<i>Section 1. Executive summary</i>	2
<i>Section 2: Significant audit and accounting matters</i>	4
<i>Section 3. Financial performance</i>	6
<i>Section 4. Governance and internal control</i>	8
<i>Section 5. Fraud</i>	10
<i>Section 6. Independence</i>	11
Appendix 1: Journals insight	12

Section 1. Executive summary

Introduction

We set out in this report our significant findings from our audit of the National Library of Scotland (“NLS”) for 2014/15, together with those matters which auditing standards require us to report to you as “those charged with governance” of NLS.

We carried out our audit work in line with our 2014/15 audit plan that we presented to you on 16 February 2015. Our audit is not designed to identify all matters that may be relevant to you. Accordingly, the audit does not identify all such matters. 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.

Framework for Our Audit

Our audit is conducted in accordance with Auditing Standards (International Standards on Auditing (‘ISAs’) (UK and Ireland)) and the Code of Audit Practice (‘the Code’).

The Code explains how external auditors should carry out their functions under the Public Finance and Accountability (Scotland) Act 2000. The audit of financial statements is covered by engagement and ethical standards issued by the UK Auditing Practices Board (APB), so the Code focuses more on the wider functions of public sector auditors. We have conducted our audit in accordance with the relevant requirements of the Code.

Respective Responsibilities of Management and Auditors

Management

It is the responsibility of the Board and the National Librarian, as Accountable Officer, to prepare the financial statements in accordance with Section 12(1-3) and 13(1-4) of Schedule 1 of the National Library of Scotland Act 2012 and directions made there under. This means:

- acting within the law and ensuring the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements timeously which give a true and fair view of the financial position of the entity and its expenditure and income for the year ended 31 March 2015; and
- preparing an Annual Report, a Governance Statement and a Remuneration Report.

Auditors’ responsibilities

Our responsibilities in accordance with the Code of Audit Practice are to provide you with an audit report stating whether, in our opinion the financial statements and the part of the Remuneration Report to be audited and give an opinion on:

- whether they give a true and fair view of the financial position of the entity and its expenditure and income for the year;
- whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements;
- whether the information which comprises the annual report included with the financial statements is consistent with the financial statements; and

- whether expenditure and receipts have been incurred and applied in accordance with guidance from Scottish Ministers (the regularity opinion).

We are also required to review and report as necessary on other information published with the financial statements, including the annual report, annual governance statement, statement on internal control and the remuneration report.

Financial Statements

The draft accounts were of good quality. We proposed only minor disclosure audit adjustments to the draft financial statements. There are no unadjusted misstatements at the conclusion of our audit, as these have been resolved and accepted by management.

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion on 21st September 2015.

Financial performance

NLS's key financial performance for the period is as follows:

- The final outturn was £19.328m against a Scottish Government operating resource limit of £18.998m, resulting in an £0.33m overspend. However, the final outturn is below the Libraries original budgeted outturn of £19.533m.
- An underspend of £0.004m in financial year 2014/15 and the impact of depreciation release due to the revaluation has resulted in an increase to the general reserve of £0.100m
- Capital expenditure in the period was £2.930m which exceeded the Scottish Government capital resource limit of £2.875m by £0.055m this variance was funded from the Designated Purposes reserve.
- Total incoming resources for 2014/15 increased by 10.8% from prior year to £18.766million (including £16.618 Grant-In-Aid funding).
- Expenditure in 2014/15 decreased from prior year by £0.688m.
- The budget for 2015/16 has an operating resource limit of £20.793m which is an increase of £1.795m (9%) on 2014/15 (£18.998m). Increase in the budget for 2015/16 is due to an increase in capital expenditure allocation intended for external fabric repair works for Causewayside building. We have not identified any key indicators or been made aware of any factors that would suggest that NLS will fail to meet its financial targets.

Additional insight – journals

A key focus in our audit is sharing insight. During our audit procedures, for testing manual journals, we have interrogated the data from which we performed our manual journals testing to identify observations for your consideration. These are included within Appendix 1.

Please note that copies of this report will be sent to the Audit Scotland in accordance with their requirements.

We would like to thank the management and staff of NLS for their co-operation and assistance during the course of our work.

Section 2: Significant audit and accounting matters

We have set out in this section the significant matters arising from our audit.

Matters identified in our audit plan

Set out below is a summary of our response to matters identified in our audit plan:

Matter arising	Audit response
<p><i>Fraud and management override of controls</i> ISA (UK&I) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk that management may override controls in order to manipulate the financial statements.</p>	<p>We performed procedures to:</p> <ul style="list-style-type: none"> • Test the appropriateness of journal entries using Computer Assisted Audit Techniques, we have provided an analysis of the type of journals posted, see appendix 1 for more details; • Review accounting estimates for bias and evaluate whether circumstances producing any bias, represent a risk of material misstatement due to fraud; • Evaluate the business rationale underlying significant transactions; and • Perform ‘unpredictable’ procedures. <p>We did not identify any issues to report to you as a result of our work.</p>
<p><i>Recognition of expenditure</i> Under ISA (UK&I) 240 there is a (rebuttable) presumption that there are risks of fraud in revenue recognition. There is a risk that NLS could adopt accounting policies or treat income transactions (specifically charging scheme income) in such a way as to lead to material misstatement in the reported revenue position.</p> <p>We have rebutted the risk of fraud in revenue recognition and have extended this presumption to the recognition of expenditure in the public sector, as there is arguably greater risk associated with the recognition of expenditure in NLS due to the nature of its funding.</p>	<p>We obtained an understanding of key expenditure controls.</p> <p>We evaluated and tested the accounting policy for expenditure recognition to ensure that this is consistent with the requirements of the Financial Reporting Manual (FReM).</p> <p>We performed detailed testing of expenditure transactions, focussing on the areas we consider to be of greatest risk.</p> <p>We did not identify any issues to report to you as a result of our work.</p>

Materiality

We have conducted our work in accordance with the materiality levels detailed below. Our materiality levels are shown below. As noted in the audit plan agreed with the Audit Committee, overall materiality was based on 2% of total assets for the year ending 31 March 2015. As a result of updating materiality figures with the actual

results per the financial statements materiality figures increased due to the revaluation of properties as at 31 March 2015.

	£
Overall materiality – This is the amount we have applied in assessing the overall impact on the group financial statements of potential adjustments	£2,069,720
Performance materiality - We have applied this to direct the amount of work performed over each financial statement line item – for example in calculating sample sizes	£1,552,290
De-minimis posting level - Under ISA (UK & I) 450, we are required to report to the Audit Committee on all unadjusted misstatements in excess of a ‘de-minimis’ or ‘clearly trifling’ amount	£103,486

Misstatements and significant audit adjustments

There are no uncorrected misstatements arising from our audit to report to you.

Qualitative aspects of accounting practices

Financial statement disclosures

We have also reviewed, and tested, the material disclosures in the financial statements. We identified some errors within the disclosures of the financial statements and these were addressed by Management. We identified no significant issues as part of this work.

Governance Statement

The Financial Reporting Manual requires the National Librarian to sign a Governance Statement which covers all controls including financial, operational, compliance and the management of risk.

We reviewed the governance statement and considered the following:

- Compliance with the required elements as published by the Scottish Public Finance Manual; and
- Consistency with the remainder of information presented within the annual accounts and our overarching understanding of the entity.

Based on our normal audit procedures, **we do not disagree** with the disclosures contained in the Statement.

Section 3. Financial performance

Financial targets

Table 1: Financial targets summary 2014/15

The below table shows the outturn for the year against the Scottish Government resource limits.

	Outturn £ 000	SG Limits £ 000	Underspend/ (Overspend) £ 000
Total Capital Resource	2,930	2,875	55
Operating Expenditure (Cash)	13,015	13,243	(228)
Collection Purchases	911	500	411
Depreciation / Impairment (Non-cash)	2,472	2,380	92
Total Operating Resource	16,856	16,618	238

NLS had minor variances to Scottish Government resource limits during the year. Key areas of expenditure include:

- Staff costs (53% of total operating expenditure) – Staff costs increased by £0.745m, mainly as a result of an increase in staff numbers (FY15 - 291, FY14 - 280).
- Other operating charges (35% of total operating expenditure) – Other operating charges have decreased by £1.755m from the prior year. This decrease is mainly due to a one-off grant of £2.1million to the NLS Foundation in prior year. Building maintenance costs increased in the current year by £1.634m from prior year reflecting external fabric repairs to George IV Bridge and Causewayside buildings.
- Collection purchases exceeded the Grant in Aid allocation by £0.411 as purchases made to add to the Libraries collections were additionally supported by fundraising and a transfer from reserves.

Efficiency savings

The Scottish Government has set an overall expectation of 3% efficiency savings for public sector bodies. During 2015/16 NLS plans to make efficiencies or raise extra income totalling £508,000 or approximately 3.8% of the revenue Grant in Aid. NLS have identified the savings required in 2015/16 and are in the process of completing a detailed plan identifying the source of savings for 2016/17 and 2017/18.

Financial sustainability

Financial sustainability has become a key matter for consideration by all public sector entities and it is vital that consideration of longer term financial plans has taken place.

The Financial Plan for 2015/16 identifies the following key areas of income and expenditure:

Table 5: 2015/16 Financial Plan

NLS	2015/16 Planned Budget £ 000
Grant in Aid – Revenue	13,313
Grant in Aid - Capital	5,600
Total Grant in Aid	18,913
Other Income	1,879
Total income	20,792
Expenditure	20,792
Surplus / (Deficit)	0

2016/17 and beyond

Cost pressures and efficiencies

NLS's strategy 2015 to 2020 highlights that the financial environment will continue to present challenges. Currently NLS is estimating that the Library will be required to save or raise at least £670k as part of setting the 2016/17 and 2017/18 budgets. NLS have begun to prepare draft budgets for 2016/17 and 2017/18. Given the uncertainty of grant in aid, the budgets have been prepared assuming no change in the level of grant in aid funding.

Deficiency	Recommendation	Management Response
<p>The 2015/16 budget identifies a need for efficiency savings of £508k during 2015/16 and of at least £670k per annum during 2016/17 and 2017/18.</p> <p>We acknowledge that NLS are in the process of identifying how it will deliver these savings for 2016/17 and 2017/18, however, a there is a lack of a detailed plan on how these savings will be delivered at this stage.</p>	<p>Management should ensure they progress the exercise being undertaken to identify potential savings areas, and develop cost savings proposals.</p> <p>Detailed plans should then be developed to set out how the changes will be implemented to realise these savings. This should be presented to the Audit Committee for their review.</p>	<p>Agreed – work is ongoing in relation future year budgets. Plans to deliver efficiencies/savings will be shared with the Audit Committee and Board.</p>

Section 4. Governance and internal control

Governance structure

NLS is governed by a Board that is appointed by the Scottish Government. The Board is responsible for ensuring that NLS 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. Scottish Ministers appointed five new Board Members in March 2015.

The Board is supported by a Senior Management Team, the Audit Committee, which has responsibility for monitoring risk and internal control, the Governance Committee and the Staffing & Remuneration Committee.

During the year Dr John Scally was appointed as the new National Librarian (Chief Executive) and took up post in September 2014.

We consider that the governance arrangements in place are appropriate.

System of internal control

The National Librarian in conjunction with management and the Audit Committee is responsible for developing and implementing systems of internal financial control and having in place proper arrangements to monitor their adequacy and effectiveness in practice.

We review these arrangements for the purposes of our audit of the financial statements and for our review of the annual governance statement and report to you any significant deficiencies in internal control that we find during our audit.

The significant matters that, in our professional judgement, we believe we should bring to your attention are set out in the table below. No significant matters were identified in the current year; however, we have provided an update on prior year recommendations.

Deficiency	Recommendation	2015 Update
<p>Review of Manual Journals</p> <p>In prior year we tested a sample of 20 manual journals and noted that 6 of them had not been reviewed and signed off by a second person until at least 3 months after the journal was posted.</p>	<p>We recommend that manual journals are approved and signed off by a second person within one month of being posted.</p> <p>Management response:</p> <p>We accept this recommendation and will aim to review journals more promptly.</p>	<p>We have tested a sample of manual journals and have not noted any journals which had not been authorised within a month of posting.</p>

Based on our work performed we consider the systems of internal control to be appropriate.

Risk management

NLS has an established risk management process within the organisation. NLS has a published Risk Policy and Appetite document and maintains Departmental, Corporate and Strategic Risk Registers.

NLS requires Heads of Department to formally sign off their Departmental Risk Registers (DRRs) each quarter. Risks ranked as Medium or above are escalated to the Corporate Risk Register (CRR). The updated CRR is agreed on a quarterly basis by the Library Leadership Team (LLT). The CRR forms the basis of the Library's Strategic Risk Register (SRR) which is presented to the Audit Committee and the Board quarterly.

Internal Audit

As described in our Annual Plan, International Standard on Auditing (UK and Ireland) 610: "Using the work of internal auditors" requires us to:

- Consider the activities of Internal Audit and the extent that their work can be relied upon for external audit procedures;
- Obtain sufficient understanding of internal audit activities and the effectiveness of the function to enable us to identify areas of risk and develop an effective and targeted audit approach; and
- Evaluate and test the quality and timeliness of internal audit work, where we seek to rely on the findings, in order to confirm its adequacy for our purposes.

The Compliance, Audit & Review Manager as supported by Henderson Loggie has completed the internal audit plan for 2014/15. PwC staff attended Audit Committee meetings where internal audit reviews were presented. We assessed the internal audit reports issued during the year and considered any potential impact on our audit. As in prior years, we have taken no reliance on the work performed by internal audit.

Based on audit work performed we consider the Internal Audit function to be appropriate for the needs of the Board.

Other matters

Compensation and Confidentiality Agreements

NLS has agreed one voluntary redundancy agreements during the 2014/15 year. As standard practice, this agreement has a confidentiality clause within the contract.

Section 5. Fraud

International Standards on Auditing (UK&I) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors and management are summarised below:

Auditors' responsibility

Our objectives are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
- to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- to respond appropriately to fraud or suspected fraud identified during the audit.

Management's responsibility

Management's responsibilities in relation to fraud are:

- to design and implement programmes and controls to prevent, deter and detect fraud;
- to ensure that the entity's culture and environment promote ethical behaviour; and
- to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalisation.

National Fraud Initiative (NFI)

NLS participates in the National Fraud Initiative (NFI). They have identified 282 (32 recommended) matches for the 2014/15 year and management have investigated and uploaded results on to the national NFI system. In accordance with our responsibilities as your appointed auditor, we have completed the NFI questionnaire and have made the following observations:

- all 282 matches, including 32 recommended, have been processed, with commentary included on the NFI website; and
- no frauds or overpayments have been identified through investigations made.

Prevention and detection of fraud and corruption

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. As part of our external audit, we have reviewed NLS's high level arrangements for preventing and detecting instances of fraud and corruption. There are no matters we wish to bring to your attention concerning fraud.

NLS's internal control environment is designed to prevent and detect instances of fraud, specifically through published anti-fraud policies and procedures, segregation of duties and authorisation processes. All fraud is investigated by the Fraud Response Group and communicated to the Board and Audit Committee by the Fraud Response Co-Ordinator. There is a whistleblowing policy in place, which was reviewed during 2014/15. No instances of fraud/corruption were reported during the year through the whistleblowing policy.

Based on audit work performed we consider that the controls in place to prevent and detect fraud or corruption to be suitable for the operations of the Board.

Section 6. Independence

Independence and objectivity

We have made enquiries of all PricewaterhouseCoopers' teams providing services to you and of those responsible in the UK Firm for compliance matters.

There are no matters which we perceive may impact our independence and objectivity of the audit team.

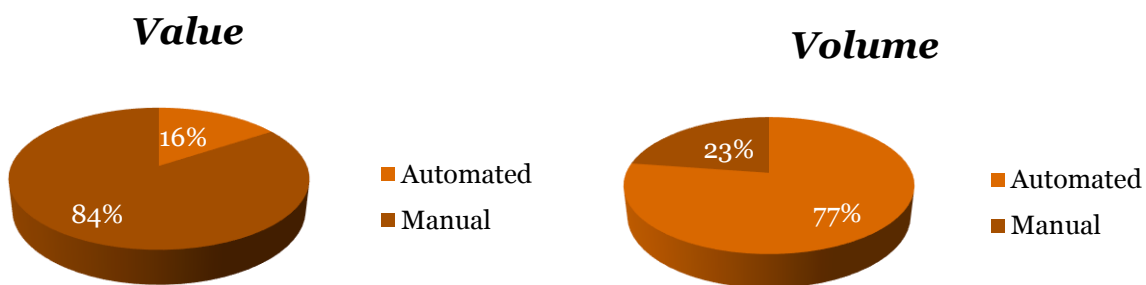
Independence conclusion

At the date of this plan we confirm that in our professional judgement, we are independent accountants with respect to NLS, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit team is not impaired.

Appendix 1: Journals insight

Automated vs Manual

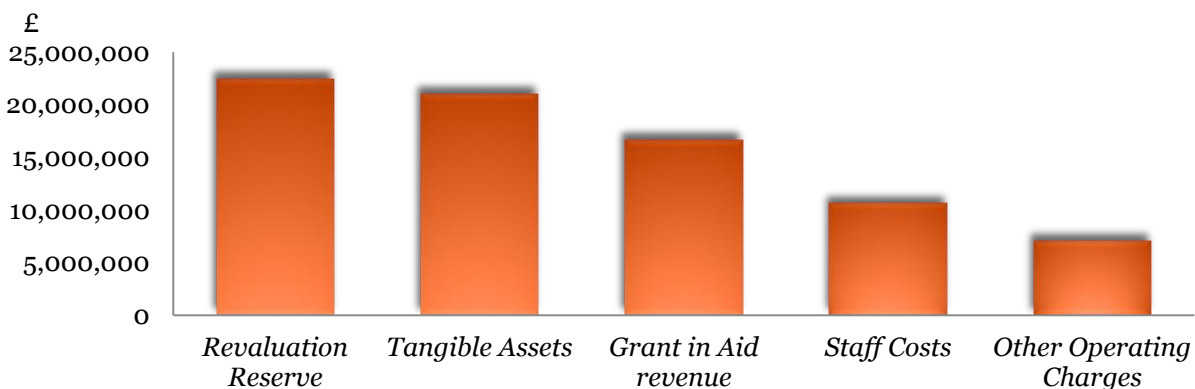
Summary Profile		
	Quantity	Value (GBP)
Total journals	14,444	£150,833,488
Total manual journals	3,273	£127,027,051



The above table and graphs demonstrate that by value 84% of the journals during 2014/15 were manual whereas by volume this figure was 23%.

High monetary value of manual journals during the year is reflective of property revaluation that took place during the year. Collectively the value of journals impacting either the revaluation reserve or tangible assets was £43.5m thus accounting for 34% of all manual journals. This is illustrated by the graph shown below.

Manual Journals – Top 5 Financial Statement Line Items, by Value



In the event that, pursuant to a request which NLS has received under the Freedom of Information Scotland Act 2002, it is required to disclose any information contained in this report, it will notify PwC promptly and consult with PwC prior to disclosing such report. NLS agrees to pay due regard to any representations which PwC may make in connection with such disclosure and NLS shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, NLS discloses this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

©2015 PricewaterhouseCoopers LLP. All rights reserved. PricewaterhouseCoopers refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.