
National Museums Scotland

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

Year ended 31 March 2015

19 August 2015

PricewaterhouseCoopers
141 Bothwell Street
Glasgow
G2 7EQ

Audit and Risk Committee,
National Museums Scotland,
Chambers Street
Edinburgh
EH1 1JF

19 August 2015

Ladies and Gentleman,

We are pleased to enclose our report to the Audit and Risk 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 and Risk Committee in March 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 at the Board meeting in 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 look forward to discussing our report with you on 19 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>	7
<i>Section 4. Governance and internal control</i>	9
<i>Section 5. Fraud</i>	11
<i>Section 6. Independence</i>	12
Appendix 1: Journals insight	13

Section 1. Executive summary

Introduction

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

We carried out our audit work in line with our 2014/15 audit plan that we presented to you on 9 March 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 Chief Executive, as Accountable Officer, to prepare the financial statements in accordance with directions given by Scottish Ministers in accordance with paragraph 9(3) schedule 7, the National Heritage (Scotland) Act 1985. 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 on a timely basis, 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 a Directors’ 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 directors' report, annual governance statement, statement on internal control or statement on internal financial control and the remuneration report.

Financial Statements

We received draft financial statements at the start of our fieldwork and they were of a good quality. We proposed only minor disclosure audit adjustments to the draft financial statements. There are no material unadjusted misstatements at the conclusion of our audit. One unadjusted misstatement exists which is below the materiality level, further details are included on page 5.

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion at the Board meeting in September 2015.

Financial performance

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

- The final outturn for NMS was £20.472m against an operating resource limit of £20.490m, resulting in a £0.018m underspend.
- The capital grant of £5.600m and purchase grant of £0.200m were fully utilised in the year.
- The total incoming resources for 2014/15 was £32.562m an increase of £0.979m on the prior year restated balance of £31.583m. This is predominantly due to an increase in the income generated from grant funded activities.
- As a result of increased income in the year, NMS were able to increase its charitable expenditure. Expenditure also increased from prior year by £1.937m (£28.726m 2014/15, £26.789m 2013/14) partly due increased expenditure on exhibitions and conservation and collections.

NMS have a balanced budget for 2015/16 which has been presented to and approved by the Board of Trustees. This budgets income for 2015/16 of £23.375m which include grant in aid funding of £20.522, an increase of £0.032m on 2014/15 (£20.490m). In addition to the grant in aid funding NMS have been awarded £2.200m for capital expenditure. We have not identified any key indicators or been made aware of any factors that would suggest that NMS 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 journals, we have interrogated the data from which we performed our 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 NMS 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>Risk of 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 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.</p> <p>We reviewed accounting estimates, such as depreciation and indexation, for bias and evaluated whether circumstances producing any bias, represent a risk of material misstatement due to fraud.</p> <p>We evaluated the business rationale underlying significant transactions within the year.</p> <p>We performed ‘unpredictable’ testing procedures, specifically relating to heritable assets.</p> <p>We did not identify any issues to report to you as a result of our work.</p>
<p><i>Risks of fraud in revenue recognition and expenditure recognition</i> Underlying ISA (UK&I) 240 there is a (rebuttable) presumption that there are risks of fraud in revenue recognition. There is a risk that NMS could adopt accounting policies or treat income transactions in such a way as to lead to material misstatement in the reported revenue position.</p> <p>We extend this presumption to the recognition of expenditure in the public sector, as there is arguably a greater risk associated with the recognition of expenditure in NMS, owing to the fact that it is largely funded on the basis of its ongoing resource</p>	<p>We obtained an understanding of key expenditure controls in place.</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 performed a search for unrecorded liabilities to ensure that the liabilities which ought to be included at the year-end had been included correctly.</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 and Risk Committee, overall materiality was based on 2% of total assets for the year ending 31 March 2015.

We have conducted our work in accordance with the materiality levels detailed below.

	£
Overall materiality – This is the amount we have applied in assessing the overall impact on the group financial statements of potential adjustments	£3,282,740
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	£2,462,055
De-minimis posting level - Under ISA (UK & I) 450, we are required to report to the Audit and Risk Committee on all unadjusted misstatements in excess of a ‘de-minimis’ or ‘clearly trifling’ amount	£164,137

Misstatements and significant audit adjustments

Per above we are required to report to you any identified uncorrected misstatements which exceed our de-minimis posting level. We identified one uncorrected misstatement which is detailed below:

Fixed Assets - Indexation Gain

The indexation gain recognised in the financial statements in respect of buildings has been over stated by £1.022m, as a result the revaluation reserve is also overstated by the same value. The indexation applied each year is an accounting estimate applied each year between full valuations. The incorrect BCIS All-in TP rate was used when calculating the indexation gain, which resulted in the overstated.

The above misstatement is not above performance materiality of £2,462,055 and as a result the financial statements are not materially misstated.

We have no other 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.

As a result of a technical alert issued by the Institute of Chartered Accountants in England and Wales (ICAEW) the treatment in the financial statements of gift aid donations from subsidiaries to charitable parent entities has changed.

Any gift aid donation made from a subsidiary to a parent entity, which results in the subsidiary having negative reserves, is now classified as being an illegal distribution. The gift aid payments made from NMS Enterprises Limited (NMSE) to NMS each year transferred only the profit made that year within the entity. However, NMSE has historically had negative reserves. NMSE and NMS sought legal advice after the publication of the ICAEW technical release. As a result of the legal advice, NMS made a capital injection into NMSE, by diluting its investment from £1 per share to £0.40 per share, overall reducing its investment from £500,000 to £200,000, to bring NMSE into positive reserves.

The technical release also states that gift aid payments from subsidiaries to parent entities should be classified as distributions. As such, the gift aid donation can only be recognised in either entities accounts at the date of

payment or the date of approval by the Board, whichever is first. The gift aid distribution in the current year and prior years, was paid post year end and was not approved by the Board before the year end. Historically the gift aid receipt would have been accrued within NMS accounts, which is no longer allowed. As a result, a prior year restatement has been completed in the financial statements, to recognise the gift aid donations from NMSE at the date of receipt.

We have reviewed the adjustments processed by NMS in relation to the above, and have not identified any material misstatements.

Governance Statement

The Financial Reporting Manual requires the Chief Executive 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	Budget £ 000	Underspend/ (Overspend) £ 000
Total Capital Resource	5,950	5,950	0
Operating Expenditure (Cash)	20,472	20,490	18
Depreciation / Resource Budget (Non-cash)	2,961	4,192	1,231
Purchase Grant	200	200	0
Total Operating Resource	29,583	30,832	1,249

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 budget for 2015/16 identifies the following key areas of income and expenditure:

Table 5: 2015/16 budget

	2015/16 Planned Budget £ 000
Grant in Aid – Revenue	20,522
Other Income	2,854
Total income	23,376
Expenditure	23,376
Surplus / (Deficit)	0

Expenditure includes budgeted costs including salaries, utilities and capital spend.

2016/17 and beyond

Cost pressures and efficiencies

NMS have a long term budget in place up to and including 2017/18, this has been presented to and approved by the Board. NMS recognise the cost pressures facing them in the coming years, and have assumed grant in aid will remain at the level awarded in 2015/16. The financial plan shows the deficit will continue to grow in FY 2016/17 to FY 2019/20.

Given the current funding pressures imposed on public sector bodies, and the growing funding gap, it is essential that financial saving plans are in place. In August 2015 NMS prepared a paper which sets out possible options available to them to reduce costs and increase self-generated income in the future. A plan is in place to present this paper to the Board of Trustees, and ultimately, by the end of the first quarter of 2016, determine the action that should be taken.

Section 4. Governance and internal control

Governance structure

NMS is governed by a Board of Trustees (Board) that is appointed by the Scottish Government. The Board is responsible for ensuring that NMS 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.

The Board is supported by an Executive Team, the Audit and Risk Committee, which has responsibility for monitoring risk and internal control, the Nominations and Governance Committee and the Personnel and Remuneration Committee.

We consider that the governance arrangements in place are appropriate.

System of internal control

The Director in conjunction with management and the Audit and Risk 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.

No significant matters were identified in the prior year which required follow up in the current year. We have raised no points to note in the current year.

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

Risk management

NMS has an established risk management strategy within the organisation. NMS has a published Risk Policy and maintains a Risk Register. The Board identify key risks each year, and puts in place processes to manage these risks.

The risk register is monitored by the Audit and Risk Committee.

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 internal auditors are KPMG. They have completed the internal audit plan for 2014/15. PwC staff attended Audit and Risk 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

NMS have not had any voluntary redundancy agreements during the 2014/15 year.

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)

NMS participates in the National Fraud Initiative (NFI). They have identified 195 overall matches of which 15 were 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:

- of the 15 recommended matches, 15 have been investigated (100%); 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 NMS'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.

NMS'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 suspected fraud should be brought to the attention of the Director of Finance and Planning in the first instance. Should the matter merit further investigation, a nominated senior member of staff will be assigned as an independent investigator by either the Director of Finance and Planning or Director. There is a whistleblowing policy in place, which was developed in line with the Bribery Act (2010). 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

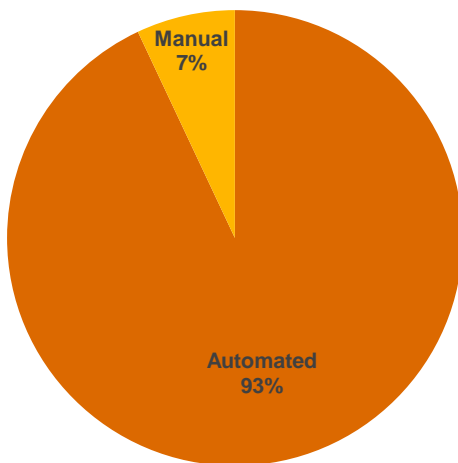
At the date of this plan we confirm that in our professional judgement, we are independent accountants with respect to NMS, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit team is not impaired.

Appendix 1: Journals insight

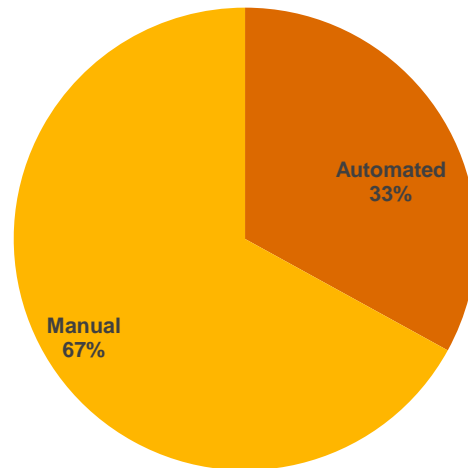
Automated vs Manual

Summary Profile		
	Quantity	Value (GBP)
Total journals	20,533	£269,405,596
Total manual journals	1,503	£180,673,176
Average no. of lines per manual journal	12	

Volume

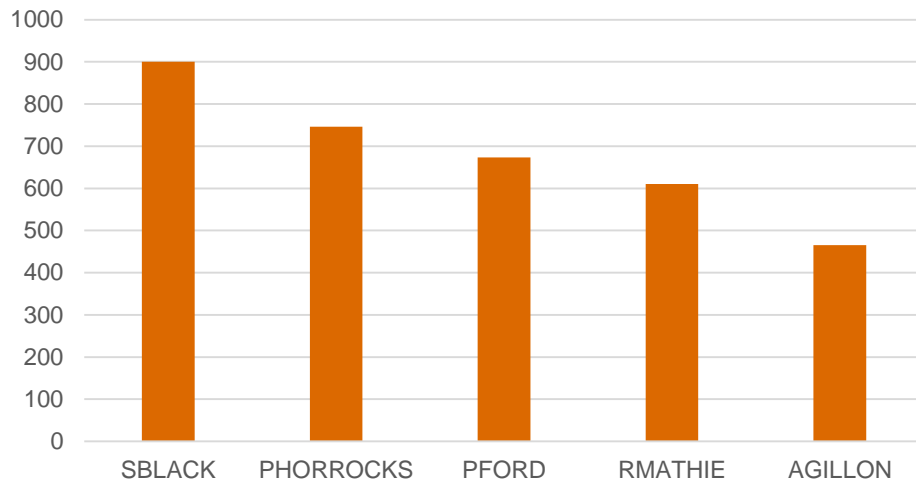


Value



Observation: 93% of journals posted during 2014/15 were posted automatically, with the remaining 7% of journals being posted manually; however we note that 67% of the total journals value for 2014/15 was as a result of the 7% of manual journals posted in the year. We ask management to consider whether this appears reasonable.

Top 5 users posting manual journals



Observation: the top five manual journal users have been portrayed in the graph above, which is in line with our understanding of the entity as they are all members of the NMS finance team and it is reasonable to assume they post manual journals as part of their role.

In the event that, pursuant to a request which NMS 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. NMS agrees to pay due regard to any representations which PwC may make in connection with such disclosure and NMS shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, NMS 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.