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# *National Library of Scotland*

Annual Report to the Audit  
Committee and the Auditor  
General for Scotland -

Year ended 31 March 2012

**FINAL**

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The matters raised in this and other reports that flow from the audit are only those which have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all matters arising and in particular we cannot be held responsible for reporting all risks in your business. This report has been prepared for and only for *National Library of Scotland* in accordance with the terms of our engagement letter and for no other purpose. We do not accept or assume any liability or duty of care for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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# 1 Introduction

We have pleasure in presenting this report relating to our audit of the financial statements of National Library of Scotland for the year ended 31 March 2012.

We have discussed this report with the Head of Finance as part of our audit process. The purpose of this report is to update the Committee on the progress of the audit and of any significant matters that have arisen during the course of our work.

## 1.1 Audit status

Our audit work on the draft financial statements for the year ended 31 March 2012 was carried out from the week commencing 11 June 2012. The audit is complete, subject to the following outstanding matters:

- receipt and review of legal confirmation letters from Pinsent Masons and Lindsays;
- receipt and review of the service auditor's report covering the payroll services provided by Equiniti ICS;
- the production of a final set of financial statements incorporating the proposed financial and disclosure adjustments arising from our audit work;
- approval of the financial statements and letter of representation; and
- completion procedures, including subsequent events review.

## 1.2 Audit overview and conclusions

Subject to the satisfactory resolution of the matters set out above, finalisation of the financial statements and their approval by the Audit Committee, we expect to issue an unqualified audit opinion for National Library of Scotland.

## 1.3 Findings arising from the audit

Section 2 of this report summarises the findings arising from our audit.

## 1.4 Misstatements and significant deficiencies in internal control

A summary of corrected and uncorrected misstatements is included in Appendix 1. A summary of the areas identified for improvement in relation to control deficiencies identified is included in Appendix 2.

## 1.5 Other areas of feedback

Section 4 contains other matters for the attention of those charged with governance, including elements of communication required under International Standard on Auditing (ISA) 260 (revised and re-drafted) "Communication with those charged with governance". We identified three misstatements, which have been corrected, that we believe should be brought to your attention. Two of the misstatements were not of a material nature. The material misstatement related to the application of an indexation factor to the value of land and buildings resulted. Further details are outlined in Section 4 and Appendix 1.

We look forward to the opportunity to discuss the points raised in the report with you at the Audit Committee meeting on 24 August 2012.

We would also like to take this opportunity to express our thanks for the co-operation and assistance we have received from the management and staff of National Library of Scotland throughout our work.

## 2 Audit Findings

Our understanding of the organisation developed further in the course of our planning and interim audit work, and updates to our original Audit Plan were presented to the Audit Committee in the Interim Management Letter on 13 March 2012. In this section of the report we outline the significant audit risks as identified in the updated plane and highlight the work performed around them.

### Areas of audit risk

### Audit approach

#### Consideration of fraud risk

All organisations are at risk of fraud, with specific fraud risks being:

- the potential for intentional misstatement of the financial statements;
- the misappropriation of assets; and
- management override of controls.

We will undertake a review of management's overall fraud arrangements and fraud policies such as whistle blowing policies.

Our assessment of controls will consider their effectiveness for preventing and identifying fraud, with any weaknesses highlighted to management.

We will perform audit testing of journals to ensure their legitimacy, and will incorporate unpredictability into our testing of income and expenditure.

#### Recognition of operating expenditure

There is a general rebuttable presumption within our audit approach that there is a risk of material misstatement due to fraud relating to revenue recognition.

For the purposes of National Library of Scotland this risk is more sensibly inverted to reflect the risk around overstatement of expenditure.

We will review the current treatment of income and expenditure to ensure that it is in accordance with the requirements of accounting standards focusing on higher risk areas such as accruals and credit notes.

Our cut-off testing will be planned to ensure that there is no overstatement of expenditure in 2011/12 and/or understatement of income.

Please note that we had initially identified an elevated audit risk regarding changes to the Government Financial Reporting Manual (FReM) that would require the majority of grants and donated assets to be recognised as income immediately rather than credited to reserves. However, following confirmation that the changes would not apply to National Library of Scotland the risk was removed.

We have included a summary of our findings below:

## Our response to the areas of audit focus identified in the audit plan:

Risk identified/area of audit focus	Audit response
Consideration of fraud risk <b>Significant risk</b>	In accordance with our audit plan, we tested significant journals and a sample of lower value journals to ensure unpredictability, and examined management's accounting estimates for bias. We can confirm that our work in this area did not find any potential frauds.
Recognition of operating expenditure <b>Significant risk</b>	We evaluated and tested the key controls over the expenditure cycle. We reviewed and tested a sample of operating expenditure transactions, with a particular focus on the risk of cut-off errors in transactions around the year-end. We can confirm that our work in this area did not identify any errors that required adjustment to the financial statements.

Our work in relation to our significant risks has resulted in no errors being identified that require an adjustment to be made to the financial statements.

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# 3 *Financial Performance*

## 3.1 Financial performance – 2011/12

NLS is facing an increasingly challenging financial environment with total in-year income having reduced by £2.791 million to £17.172 million (2010/11 £19.963 million). Whilst income across all major expenditure areas has been reduced the biggest single reduction is the Grant in aid being reduced by £1.447 million. The Scottish Government has indicated to NLS that this level of Grant in aid will continue in future years although confirmation of final future allocations other than for 2012/13 has not been provided.

To effectively manage the reduced funding NLS has reduced expenditure significantly by £1.725 million from £19.176 million in 2010/11 to £17.451 million in 2011/12. NLS have achieved this primarily through a £1.5 million saving in staffing, which has included a number of early retirements.

## 3.2 Financial outlook – 2012/13 and beyond

The NLS Board approved a balanced budget for 2012/13 and Corporate Plan for 2012-2015 in April 2012. Estimates of future Grant in aid allocations have been included for future years but these have not yet been confirmed by Scottish Government. The 2012/13 budget estimates includes a reduction in Grant in aid from £15.675 million to £14.325 million in 2012/13, with £1.1 million being as a result of a reduction to the capital grant.

As highlighted in the Corporate Plan ongoing efficiency savings of 3% annually will be required to achieve a balanced budget. The source of savings is to be identified on an annual basis.

NLS faces a number of cost pressures arising from the buildings and plant. In particular, the roof of the NLS Causewayside building requires significant remedial work estimated at a cost of £5 million. The Scottish Government has agreed to provide £2.25m over 2013-14 and 2014-15 to begin the remedial programme. However with a reduced capital budget NLS will need to continue to manage their capital budget effectively to maintain the quality of the existing estate.

## 3.3 Financial Management and Leadership

It is commendable to note that the organisation has done well to achieve the recurring financial efficiencies in previous years.

Management should continue to demonstrate strong leadership and the promotion of an efficiency and savings culture. This leadership will include robust monitoring and reporting on progress against any savings plans, and taking early action to avoid slippage within any savings schemes identified.

# 4 Communications required under ISA 260

The following table contains communication required under ISA 260 (revised and re-drafted) “Communication with those charged with governance”.

Requirement	Delivery of requirement
Uncorrected and corrected misstatements	We identified three misstatements, which have been corrected, that we believe should be brought to your attention. Two of the misstatements were not of a material nature. The material misstatement related to the application of an indexation factor to the value of land and buildings resulted. Further details are included below.
Significant accounting principles and policies	Significant accounting principles and policies are disclosed in the notes to the financial statements. Board members will represent to us that they have considered the accounting policies and that there have not been any material changes in the accounting principles and policies used during the year.
Significant qualitative aspects of the organisation’s accounting practices and financial reporting, management’s judgments and accounting estimates	<p>The only significant accounting estimate that was required in the preparation of the financial statements was the selection of an appropriate index for the valuation of property.</p> <p>Over several years management employed the Office for National Statistics’ Output Price Index for Public Works (OPI). This index is not suited to the valuation of buildings as it is based on the cost of materials used for new build construction rather than the value of similar property. PwC recommends the Building Cost Information Service All in Tender Price Index (BCIS), which is also used by the District Valuer to inform their quinquennial valuations.</p> <p>There is an material difference of £5.396 million between the net book value (NBV) of fixed assets indexed using OPI as at 31 March 2012 and the same assets indexed using BCIS. This consists of an understatement of £0.414 million in the depreciation charged to the Income and Expenditure account, and an understatement of £5.150 million in the cumulative revaluation gains processed through reserves since the last formal revaluation. We have proposed adjustments in respect of this which are detailed in Appendix 1.</p> <p>Further, we strongly recommend that NLS adopts the BCIS index for 2012/13 onwards, which will have the dual advantages of ensuring material differences do not develop, and of minimising future gains and losses on formal revaluations.</p>
Deficiencies in the internal control environment	<p>The purpose of the audit was to express an opinion on the financial statements. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that were appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters being reported are limited to those deficiencies that we have identified during the audit and that we have concluded are of sufficient importance to merit being reported to you.</p> <p>Such deficiencies in internal controls are included in Appendix 2.</p>

Details of material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern	We have not encountered any material uncertainties which cast doubt upon the ability of National Library of Scotland to continue as a going concern.
Disagreements with management	We have not disagreed with management on any matters which, individually or in aggregate, could be significant to the financial statements that have not been adjusted as summarised in Appendix 1.
Confirmation of audit independence	We confirm that, in our professional judgment, as at the date of this document, we are independent auditors with respect to the entity and its related entities, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit engagement leader and the audit staff is not impaired.

## Governance and Performance

National Library of Scotland has a well-developed approach to risk management and performance monitoring involving the Board and the Audit Committee to ensure that organisational goals remain on track. This process has continued to be refined on an ongoing basis.

## Civil Service Pension Scheme

The majority of National Library of Scotland staff are eligible to join the Civil Service Pension Scheme. The latest actuarial valuation of the scheme was performed in 2007, and valuations are currently suspended. Management has disclosed the situation appropriately in the accounts. However, National Library of Scotland should be aware that contribution rates may increase significantly once an up-to-date valuation is performed.



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# *Appendices*

# Appendix 1 – Summary of corrected and uncorrected misstatements

The tables below set out details of the misstatements identified in the course of our substantive year-end audit work. All misstatements have been corrected with only misstatement 3 being of a material nature.

No	Description of misstatement	Income and Expenditure Account		Balance Sheet	
		Dr	Cr	Dr	Cr
1	DR Depreciation Charge  CR Accumulated Depreciation  <i>Being an adjustment to charge the correct amount of depreciation on Computer Equipment for the year.</i>	£118,000			£118,000
2	DR Collection Purchase Expenditure  CR Voluntary Income Restricted Funds  <i>Being the correction of transfer from unrestricted funds but not correctly entered into restricted funds – corresponding entry to expenditure</i>	£18,000			£18,000
3	DR Land and Buildings Cost  CR Revaluation Reserve  DR Depreciation - Indexation  DR Depreciation Charge  CR Accumulated Depreciation  DR Revaluation reserve  CR Release from revaluation reserve  <i>Being the impact of applying the BCIS All in Tender Price Index to revalue property on the depreciation charge in the year and the net book value at year end.</i>	£414,280	£414,280	£5,395,567  £41,395  £414,280	£5,395,567    £455,675
<b>Total corrected misstatements</b>		<b>£550,280</b>	<b>£414,280</b>	<b>£5,851,242</b>	<b>£5,987,242</b>

# Appendix 2 – Deficiencies in internal control

The following points detail our internal control recommendations based on the results of our current year audit. We have graded our recommendations according to their possible impact.

**(H) High** Serious matters which should be addressed as a matter of urgency

**(M) Medium** Areas where attention is required

**(L) Low** Best practice recommendations

## Bank reconciliations – Low

Finding	Recommendation
From our review of bank reconciliations, we found that the Government Banking Service accounts were incorrectly reconciled to ledgered balances, rather than available balances. This resulted in the reconciliation having been compared against incorrect bank balances.	All accounts should be reconciled to the available balance.
<b>Management response</b>	
The ledger balance was reconciled to the statement balance and equalled the amount disclosed within the financial statements.	

GBS did not provide confirmation of statement balances but instead provided cleared balances. These differed.

In future NLS will reconcile to both cleared balances and bank statement balances at the year end.

## Review of manual journals – Low

Finding	Recommendation
Manual journals are not reviewed by a second member of staff.	Management should ensure that there is a formal threshold above which journals require review and authorisation. All journals meeting these requirements should be reviewed and authorised by an appropriate second member of staff.
<b>Management response</b>	
Manual journal checking was always in place for junior members of staff, however this is now in place for senior staff members using a risk based approach.	

## Review of sales ledger and invoice processing – Low

Finding	Recommendation
<p>We noted two issues with NLS's sales process:</p> <ul style="list-style-type: none"><li>• Delays in the processing of manual invoices at year end mean that the year end debtors figure is understated, although by a small, immaterial amount in the current year; and</li><li>• There are a large number of long outstanding debts, which are provided for in full. Due to the length of time these have been due there is potentially a lower likelihood of recovery.</li></ul>	<p>NLS should ensure that all invoices are processed using the automated invoicing module.</p> <p>Management should undertake a review of the sales ledger and where debts cannot be recovered, these should be written off.</p>

### Management response

Discussions are ongoing regarding improvements in customer invoicing to ensure that finance are notified immediately of customer invoices raised, but also to minimise the number of customer invoices raised. Plans are afoot within Access to streamline the procedures in this area and an internal audit during 2012/13 will support delivery of this work.

Due to staffing issues, the Finance department was unable to undertake regular collections management. This situation has just been rectified and collections management can resume and appropriate write offs will occur.

## Authorisation of funds transfers – Low

Finding	Recommendation
<p>As part of our work on funds, we reviewed transfers between funds to ensure they were appropriately authorised by the Executive Leadership Team (ELT). However, from our sample of 10 transfers tested, in three instances no authorisation could be found and in a further two instances the amount authorised did not match the amount transferred.</p>	<p>Each transfer should be clearly authorised within minutes of ELT meetings.</p>
<p><b>Management response</b> Transfers will be clearly documented within minutes of ELT meetings in future.</p>	

## Indexation of buildings – High

Finding	Recommendation
Management employed the Office for National Statistics' Output Price Index for Public Works (OPI). This index is not suited to the valuation of buildings as it is based on the cost of materials used for new build construction rather than the value of similar property.	The Building Cost Information Service All in Tender Price Index (BCIS), which is also used by the District Valuer to inform their quinquennial valuations, should be used going forward. The data for the indexation is obtainable from the District Valuer.

### Management response

The indexation of land and buildings was updated for the financial statements and these indices will continue to be used in future. This is not considered to be a high risk in terms of internal control however it did represent a significant book adjustment.

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