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# *National Library of Scotland*

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

Year ended 31 March 2016

15 August 2016



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PricewaterhouseCoopers  
141 Bothwell Street  
Glasgow  
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The Audit Committee  
National Library of Scotland,  
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15 August 2016

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 2016. 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 2016. 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 26<sup>th</sup> September 2016. 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 15 August 2016.

We look forward to discussing our report with you on 15 August 2016. Attending the meeting from PwC will be James Gray.

Yours faithfully

PricewaterhouseCoopers LLP

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# 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 2015/16, 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 2015/16 audit plan that we presented to you on 15 February 2016. 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 2016; and
- preparing an Annual Report and a Governance Statement.

### *Auditors’ responsibilities*

Our responsibilities in accordance with the Code of Audit Practice are to provide you with, an audit report on the financial statements stating whether:

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

- 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 and statement on internal control.

## Financial Statements

A full set of draft accounts were available at the start of the audit fieldwork and 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 26<sup>th</sup> September 2016.

## Financial performance

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

- The final operating expenditure outturn was £13.294m against a Scottish Government operating resource limit of £13.313m, resulting in an £18k underspend.
- Capital expenditure in the period was £5.033m which was less than the Scottish Government capital resource limit of £5.100m by £67k. This variance was transferred to the Designated Purposes reserve.
- Total incoming resources for 2015/16 increased by 8.4% from prior year to £20.336million (including £16.618 Grant-In-Aid funding).
- Expenditure in 2015/16 decreased from prior year by £0.851m.
- The budget for 2016/17 has an operating resource limit of £22.291m which is an increase of £0.998m (4.6%) on 2015/16 (£21.293m). Increase in the budget for 2016/17 is due to an increase in capital expenditure allocation intended for the Kelvin Hall project. 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

We identified two significant risks in our initial audit plan; the risk of fraud and management override of controls and the recognition of income and expenditure. We have also identified a further elevated risk around Financial Sustainability, as detailed in Section 3.

Significant Risk	Audit response
<p><b><i>Fraud and management override of controls</i></b> ISA (UK&amp;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"> <li>• 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;</li> <li>• Review accounting estimates such as indexation for bias and evaluate whether circumstances producing any bias, represent a risk of material misstatement due to fraud;</li> <li>• Evaluate the business rationale underlying significant transactions; and</li> <li>• Perform ‘unpredictable’ procedures.</li> </ul> <p><b>We did not identify any issues to report to you as a result of our work.</b></p>
<p><b><i>Recognition of expenditure</i></b> Under ISA (UK&amp;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><b>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.</b></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 (FRoM).</p> <p>We performed detailed testing of expenditure transactions, focusing on the areas we consider to be of greatest risk.</p> <p><b>We did not identify any issues to report to you as a result of our work.</b></p>

<i>Elevated Risk</i>	<b>Audit Response</b>
<p><b><i>Adoption of FRS 102/Charities SoRP</i></b>  NLS have prepared financial statements under FRS 102 and the Charities SoRP 2015 for the year ending 31 March 2016. This has resulted in presentational changes to the primary financial statements, a more detailed Trustees' report and review of prior year figures to determine if restatement is required.</p>	<p>We reviewed management's assessment of the impact of FRS 102 and the Charities SoRP on the financial statements. We reviewed the Trustee's reports to ensure it is compliant with the Charities SoRP.</p> <p>There were no material adjustments made to the financial statements as a result of the transition to FRS 102.</p> <p>Revenue recognition under the Charities SoRP 2015 was discussed with Management. It was noted that NLS may have grants which are not deemed to have performance related conditions attached. For some of these grants income is received upfront, and in-line with the SoRP the income should be recognised in the year received (and not in line with expenditure).</p> <p>From discussion with Management and review of the working papers we noted that Management have taken the approach to match grant income against expenditure. Without a full review of all grant income received in the year and all grant conditions, we are not able to determine the full value associated with these types of grants, however, the total value of deferred income (i.e. the value of any income which potentially should have been recognised in the year) is £493k which is below performance materiality of £1.551m and so this value has not been adjusted. However, we do acknowledge that the SoRP is open to interpretation on what qualifies as a performance related grant. In addition, we are aware that some of the grants received by NLS, would likely be deemed as performance related.</p> <p><b>Although this has not resulted in a material misstatement, the accounting treatment taken is not fully in compliance with the Charities SoRP. We recommend that Management liaise with OSCR and Scottish Government to identify a sensible solution going forward.</b></p>
<p><b><i>Wider scope audit risk – financial sustainability</i></b>  There is unprecedented financial pressure on the public sector as a result of ever increasing demand during a period of financial austerity in UK public services.</p> <p>This is leading to public sector bodies across the country finding it increasingly difficult to fill budget gaps through the identification of efficiency savings. As a</p>	<p>We obtained an understanding of processes in place around budgetary controls and forecasting.</p> <p>We performed the following substantive procedures:</p> <ul style="list-style-type: none"> <li>Reviewed financial performance forecasts and budgets for 2016/17 and beyond, and assessed these for accuracy against known</li> </ul>

<p>result there is an increasing audit risk that entities do not have detailed plans to show financial sustainability over the next 3-5 years.</p>	<p>budget cuts. Assumptions used were assessed for reasonableness.</p> <ul style="list-style-type: none"> <li>• Reviewed evidence of Board approval of budgets; and</li> <li>• Reviewed evidence of cost saving measures being implemented.</li> </ul> <p><b>We noted that detailed plans are in place for 2016/17 and high level cost saving measures have been detailed and presented to the Audit Committee and Board. However, Management should continue to prepare more detailed plans on cost saving measures over the medium term. See section 3 of this report for more details.</b></p>
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## 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 2016. As a result of updating materiality figures with the actual results per the financial statements there was a very minor decrease in the materiality figures.

	£
<b>Overall materiality</b> – This is the amount we have applied in assessing the overall impact on the charity financial statements of potential adjustments	<b>£2,068,160</b>
<b>Performance materiality</b> - We have applied this to direct the amount of work performed over each financial statement line item – for example in calculating sample sizes	<b>£1,551,120</b>
<b>De-minimis posting level</b> - 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	<b>£103,408</b>

## 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 minor 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 and the Chair of the Board 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

#### Financial targets summary 2016/17

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

	<b>Outturn £ 000</b>	<b>SG Limits £ 000</b>	<b>Underspend/ (Overspend) £ 000</b>
Total Capital Resource	5,033	5,100	67
Operating Expenditure (Cash)	13,295	13,313	18
Collection Purchases	500	500	0
Depreciation / Impairment (Non-cash)	2,408	2,380	(28)
<b>Total Operating Resource</b>	<b>21,236</b>	<b>21,293</b>	<b>57</b>

The final outturn was in line the Scottish Government resource limits with only minor variances noted at year end. A key factor in the increase in expenditure from prior year to current year is due to the increased costs associated with the Causeway side project.

### Efficiency savings

Due to a cut in grant in aid and cost pressures, it is essential that public sector bodies review financial plans to identify potential efficiency savings. In addition, the Scottish Government has set an overall expectation of 3% efficiency savings for public sector bodies.

NLS have detailed financial plans in place noting the funding gap in place each year. For 2016/17 plans in place detail efficiencies or increases in self-generated income totalling £600,000 or approximately 4.6% of the revenue grant. These savings will be used two ways, they will offset the real terms decrease in revenue grant funding and will be re-invested into operational activities to help the Library to continue delivering its service requirements.

These efficiencies will be achieved through a combination of:

- Generating additional income and ensuring that there is full cost recovery across services;
- Managing services in 2016/17 so that efficiency savings are generated across all areas, particularly in relation to staffing;
- Constraining cost growth through effective demand management, good financial control by managers and by effective negotiation with suppliers.

### Financial sustainability

Per Audit Scotland guidance, Financial Sustainability has been added as an elevated risk in addition to those risks identified in our audit plan. Financial sustainability has become a key matter for consideration by all public sector

entities and given the grant in aid cuts and cost pressures mentioned above it is vital that consideration of longer term financial plans has taken place.

The Financial Plan for 2016/17 identifies the following key areas of income and expenditure:

### 2016/17 Financial Plan

NLS	2016/17 Approved Budget £ 000
Grant in Aid – Revenue	13,180
Grant in Aid – Capital	7,000
<b>Total Grant in Aid</b>	<b>20,180</b>
Other Income	2,111
<b>Total income</b>	<b>22,291</b>
<b>Expenditure</b>	<b>22,291</b>
<b>Surplus / (Deficit)</b>	<b>0</b>

In 2016/17, the reduced GIA funding and increased cost pressures, such as increased social security costs and pay increases resulted in NLS having to fill a gap of £640k. NLS have been able to fund the gap through increased self-generated income of circa £160k and cost savings through a Senior Management restructure.

## 2017/18 and beyond

### *Cost pressures and efficiencies*

NLS's strategy 2015 to 2020 highlights that the financial environment will continue to present challenges. Plans prepared in 2015 show NLS is estimating that the Library will be required to save or raise at least £470k as part of setting the 2017/18 and 2018/19 budgets. This equates to approximately 3% of the core Library budget.

We raised a recommendation in the prior year (see table below) around the need review cost saving measures and prepare detailed plans. In February 2016, a paper was presented to the Audit Committee and the Board detailing the ways in which costs will be reduced going forward and how the saving will be accounted for. Examples of the ways NLS are planning to reduce costs in the medium term include reviewing staff turnover and staff costs, and they plan on increasing income through holding more events.

Despite medium term plans being in plans, detailing at a high level the measures that will be implemented to reduce costs and increase income, Management should continue to develop more detailed medium term plans, noting the income, expenditure and cost savings measures they implement.

Deficiency noted in 2014/15	Recommendation noted in 2014/15	Follow up 2015/16
<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</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</p>	<p>As noted above, plans have been presented to the Audit Committee and the Board on the detailed cost saving measures for 2016/17 and high level plans for 2017 onwards.</p> <p>Management should continue to develop medium terms</p>

<p>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>realise these savings. This should be presented to the Audit Committee for their review.</p> <p><b>Management response:</b></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>	<p>plans noting in detail the cost savings measures for these years, similar to the task undertaken for 2016/17.</p>
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# ***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.

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.

The Senior Management restructure took place during the year. During the year Darry Mead vacated his role in July 2015 and Duncan Campbell switched from fulfilling his role on a full-time basis to beginning a part-time secondment with the Scottish Government from the beginning of August 2015.

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.

We are pleased to report that we did not note any significant matters that, in our professional judgement, we believe we should bring to your attention. No significant matters were raised in the prior year that require follow up.

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. This process will be used to manage those risks that arise in managing a budget and finances over the coming years.

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.

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## 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.

Henderson Loggie has completed the internal audit plan for 2015/16. 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***

There were no compulsory redundancies during the year. Redundancy and other departure costs have been paid in accordance with the provisions of the Civil Service Compensation Scheme, a statutory scheme made under the Superannuation Act 1972.

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## ***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.

### **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 2015/16. 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.

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## ***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**

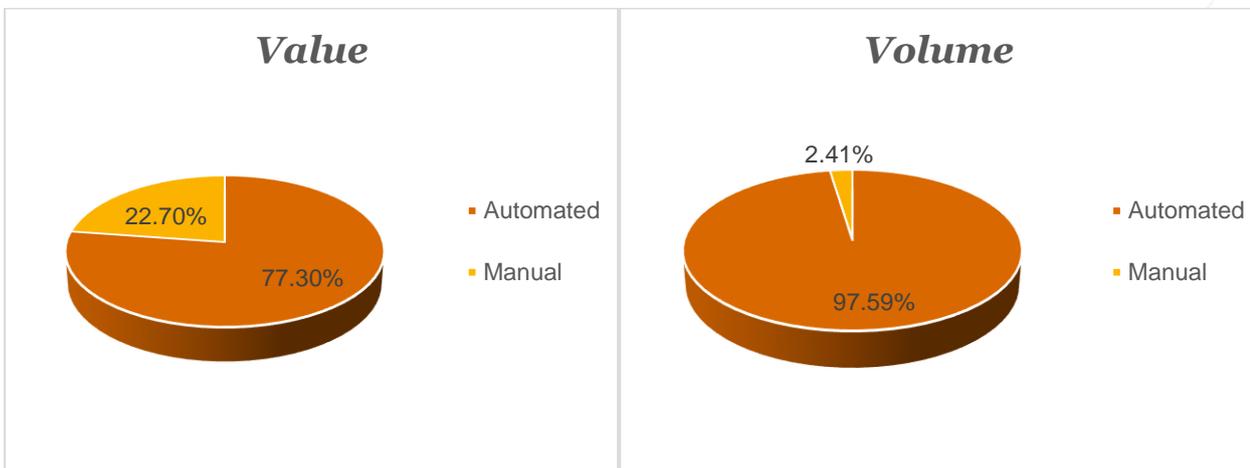
At the date of this plan we confirm that in our professional judgement, we are independent accountants with respect to NLS, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit team is not impaired.

# Appendix 1: Journals insight

## Automated vs Manual

### Summary Profile

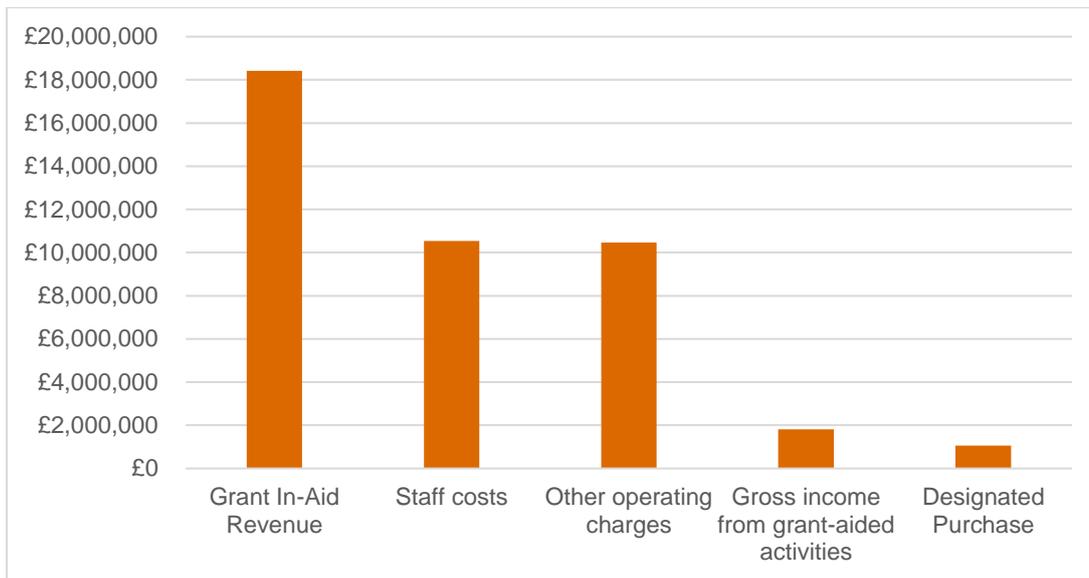
	Quantity	Value (GBP)
<b>Total journals</b>	<b>12,359</b>	<b>£116,654,670</b>
<b>Total manual journals</b>	<b>305</b>	<b>£34,248,082</b>



The above table and graphs demonstrate that by value 22.70% of the journals during 2015/16 were manual whereas by volume this figure was 2.4%.

The value of the manual journals has fallen in the year due to there not being the revaluation of property that occurs every 5 years which occurred in the prior year. In the current year the value of manual journals largely impacted Grant In-Aid Revenue, Staff Costs and Operating charges as illustrated in 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.*

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