

# National Galleries of Scotland

Annual Audit Plan 2016/17



 AUDIT SCOTLAND

Prepared for National Galleries of Scotland

February 2017

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Risks and planned work

1. This annual audit plan contains an overview of the planned scope and timing of our audit of National Galleries of Scotland ("NGS") and is carried out in accordance with International Standards on Auditing (ISAs), the [Code of Audit Practice](#), and any other relevant guidance. The wider scope of public audit contributes to conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

## Audit risks

2. Based on our discussions with management, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for NGS. We have categorised these risks into financial risks and wider dimension risks. The key audit risks, which require specific audit testing, are detailed in [Exhibit 1](#).

## Exhibit 1

Audit Risk	Management assurance	Planned audit work
<b>Financial statement issues and risks</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<p>Due to the nature of this risk, Audit Scotland does not accept assurances from management.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>
<p><b>2 Risk of fraud over income and expenditure</b></p> <p>NGS receives a significant amount of income in addition to Scottish Government funding (2015/16 - £7.164m). The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud. The Code of Audit Practice expands the ISA assumption to advise there is also a risk of fraud over aspects of expenditure, for public sector bodies.</p>	<p>Effective budget monitoring by management.</p> <p>Fraud Policy, Bribery Policy and Whistleblowing Policy in place.</p> <p>Participation in National Fraud Initiative.</p>	<p>Detailed substantive testing of revenue and expenditure transactions, focusing on the areas of greatest risk.</p> <p>Audit work on the National Fraud Initiative matches.</p>

Audit Risk	Management assurance	Planned audit work
<p><b>3 Accounting treatment for grants</b></p> <p>Under the Charities Statement of Recommended Practice (SORP) accounting framework, charities are required to recognise the full amount of grant income (where grants do not impose performance related conditions) immediately when there is evidence of entitlement. NGS should not defer such grant income.</p> <p>The outgoing auditors, PwC, noted in their 2015/16 report that total deferred income was £0.483m last year i.e. the value of income which potentially should have been recognised in year. This was below the materiality set by the auditors.</p> <p>Nevertheless, this presents a risk that grant income may not be accounted for in accordance with the SORP accounting framework in 2016/17.</p>	<p>Review grant conditions of each grant received, and apply revenue recognition criteria appropriately.</p> <p>Review latest Charities SORP accounting requirements.</p>	<p>Focused testing of material grant income at year-end to ensure revenue recognised in line with the Charities SORP.</p> <p>Review latest Charities SORP accounting requirements.</p>
<p><b>4 Estimation and judgements - Property Revaluation</b></p> <p>NGS's accounting policy states that land and buildings are revalued every 5 years. This revaluation is due to take place in 2016/17. There is a significant degree of subjectivity in the measurement and valuation of these properties (£94m - 2015/16).</p> <p>Management are considering how the expenditure on the Mind the Gap project will be treated in the financial statements. We will review this to ensure that only appropriate costs are capitalised.</p> <p>This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>We will instruct a reputable and qualified surveyor to revalue our properties.</p> <p>We will ensure that there is a sound procedure for the revaluation and that this is reflected accurately in the financial statements.</p>	<p>Completion of 'review of the work of an expert' for the professional valuer.</p> <p>Focused substantive testing of property revaluations.</p> <p>Focused substantive testing of Mind the Gap additions to ensure they meet criteria for capitalising.</p>
<p><b>5 Accruals Overstatement</b></p> <p>In 2015/16, PWC's audit testing identified a £1.1m overstatement of the accruals balance. PWC reported that "Management believe that this balance relates to purchase orders that have been raised (the majority during 2010-2013 and relating to the capital expenditure on the Portrait Gallery) but then never</p>	<p>During 2016/17, we will review this balance and take action to clear any historical balances. We anticipate that any required accounting adjustments will be reflected in the 2016/17 financial statements.</p>	<p>We will substantively test this as part of our financial statements' audit to ensure that this has been accounted for correctly.</p>

Audit Risk	Management assurance	Planned audit work
<p>matched to an invoice, however without a full detailed review of this balance, which would be a very time consuming exercise, it is not possible to fully evidence this."</p> <p>The result of this misstatement is an overstatement of creditors and an understatement of reserves of £1.1m.</p>		
<p><b>6 Group Accounts</b></p> <p>NGS prepares group accounts that include its subsidiary company, NGS Trading Company Limited. However, NGS doesn't consolidate its charitable foundation, National Galleries of Scotland Foundation ("the Foundation") which was created in 2012. The previous auditors, PWC, agreed with management's assessment that no consolidation of the Foundation was required, as NGS didn't control the Foundation. In this first year of our audit appointment, we will need to assure ourselves this approach is correct.</p>	<p>The Foundation is independent of NGS. There is a separate Board, with four of five members independent of NGS. It has the right to refuse to give funding to NGS. Grants issued by the Foundation are subject to performance conditions.</p>	<p>We will meet with the Chief Operating Officer and Head of Finance to understand the background to the creation on the Foundation to assist with our understanding.</p>
<p><b>Wider dimension risks</b></p>		
<p><b>7 Financial Sustainability and Financial Management</b></p> <p>NGS has medium-term financial plans in place until 2019/20. However, after the current year, NGS is projecting overspends against budget. As such, NGS continues to face a risk over its financial sustainability in the coming years due to uncertainty over future funding allocations and income sources.</p>	<p>Effective budget monitoring by the finance team.</p> <p>Regular financial reporting to the Board and Audit &amp; Risk Committee.</p> <p>Ongoing communication with the Scottish Government sponsor division.</p>	<p>Focused cut-off testing at year-end to confirm expenditure and income has been accounted for in the correct financial year.</p> <p>Review budget monitoring and medium term financial plans, following the approval of the 2017/18 budget.</p>
<p><b>8 Disaster Recovery and Business Continuity Plans</b></p> <p>NGS has a Business Continuity Plan and Disaster Recovery Plan. However, the IT arrangements in these plans do not include sufficient detail and require to be updated. This has been delayed until NGS upgrades its IT infrastructure.</p> <p>This should be a priority given recent instances of cyber attacks in the public sector.</p>	<p>The Business Continuity and Disaster Recovery Plans will be drafted in 2017/18, following the upgrading of IT infrastructure.</p> <p>Internal Audit is reviewing IT Security policies.</p>	<p>We will monitor NGS's progress in developing Business Continuity and Disaster Recovery Plans. We will review these once they are available.</p> <p>We will seek to place reliance on Internal Audit's review of IT Security and Business Continuity Management.</p>

## Reporting arrangements

- 3.** Audit reporting is the visible output for the annual audit. All annual audit plans and the outputs as detailed in [Exhibit 2](#), and any other outputs on matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).
- 4.** Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to management to confirm factual accuracy.
- 5.** We will provide an independent auditor's report to NGS, the Auditor General for Scotland and the Scottish Parliament, summarising the results of the audit of the annual accounts. We will provide the Accountable Officer and Auditor General for Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.
- 6.** Under the Public Finance and Accountability (Scotland) Act 2000, there is a requirement for the resource account of the Scottish Government and related bodies to be presented to Parliament within nine months of the financial year-end i.e. by 31 December.

## Exhibit 2

### 2016/17 Audit outputs

Audit Output	Target date	Audit Committee (or equivalent) Date
Annual Audit Plan	28 February 2017	28 February 2017
Annual Audit Report including ISA 260 requirements	29 August 2017	29 August 2017
Signed Independent Auditor's Report	12 September 2017	11 September 2017 (Board Approval)

## Audit fee

- 7.** The audit fee for the 2016/17 audit of NGS is £22,220 (2015/16 - £23,710). In determining the audit fee we have taken account of the risk exposure of NGS, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit. Our audit approach assumes receipt of the unaudited financial statements, with a complete working papers package, on Friday 23 June 2017.
- 8.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

## Responsibilities

### Audit & Risk Committee and Accountable Officer

**9.** Audited bodies have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives.

**10.** The audit of the financial statements does not relieve management or the Audit and Risk Committee, as those charged with governance, of their responsibilities.

### Appointed auditor

**11.** Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.

**12.** Auditors in the public sector give an independent opinion on the financial statements. We also review and report on the arrangements within the audited body to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.



# Audit scope and timing

## Financial statements

**13.** The statutory financial statements audit will be the foundation and source for the majority of the audit work necessary to support our judgements and conclusions. We also consider the wider environment and challenges facing the public sector. Our audit approach includes:

- understanding the business of NGS and the associated risks which could impact on the financial statements
- completing initial system reviews to assess the key controls that operate within each of the main NGS financial systems
- identifying major transaction streams, balances and areas of estimation and understanding how NGS will include these in the financial statements
- assessing the risks of material misstatement in the financial statements
- determining the nature, timing and extent of audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements are free of material misstatement.

**14.** We will give an opinion on the financial statements as to:

- whether they give a true and fair view of the financial position of the audited body and its expenditure and income
- whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements for charitable bodies
- the regularity of the expenditure and income
- the consistency between the narrative in the Annual Report of the Board and the results in the financial statements
- the consistency of the Governance Statement.

## Materiality

**15.** Materiality defines the maximum error that we are prepared to accept and still conclude that that our audit objective has been achieved. It helps assist our planning of the audit and allows us to assess the impact of any audit adjustments on the financial statements. We calculate materiality at different levels as described below. The calculated materiality values for NGS are set out in [Exhibit 3](#).



### Exhibit 3

#### Materiality values

Materiality level	Amount
<b>Planning materiality</b> - This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It has been set at 1% of gross assets for the year ended 31 March 2016 based on the latest audited accounts for 2015/16. We have used gross assets as the basis for calculating materiality as a primary function of NGS is to operate as a custodian of public assets. This approach is in line with ISA 320 Audit Materiality and Practice Note 10 - Audit of Financial Statements of Public Sector Bodies in the United Kingdom.	£2.921million
<b>Performance materiality</b> - This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 50% of planning materiality.	£1.461million
<b>Reporting threshold</b> - We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of planning materiality.	£ 30,000



16. We review and report on other information published with the financial statements including the Trustees' Annual Report, Statement of Trustees' Responsibilities and the Governance Statement. Any issue identified will be reported to the Audit and Risk Committee.

#### Timetable

17. To support the efficient use of resources it is critical that a financial statements timetable is agreed with us for the production of the unaudited accounts. An agreed timetable is included at [Exhibit 4](#) which takes account of submission requirements and planned Audit and Risk Committee dates:

### Exhibit 4

#### Financial statements' timetable

 Key stage	 Date
Latest submission date of unaudited NGS financial statements with complete working papers package	23 June 2017
Latest date for final clearance meeting with Head of Finance	14 July 2017
Agreement of audited unsigned financial statements; Issue of Draft Annual Audit Report including ISA 260 report to those charged with governance	11 August 2017
Presentation of Annual Audit Report to Audit and Risk Committee	29 August 2017
Approval of NGS Annual Report and financial Statements by Board	11 September 2017
Independent auditor's report signed	12 September 2017

## Internal audit

**18.** Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible and we carry out an assessment of the internal audit function. We are currently undertaking a formal review of the adequacy of internal audit, however we are awaiting some information.

**19.** Internal audit is provided by an external firm, TIAA. In November 2016, Chiene + Tait, NGS's Internal Auditor, transferred its internal audit function to TIAA, a separate firm. As part of this transfer, the Chiene + Tait internal audit team transferred to TIAA. NGS's management agreed to this transfer and signed a deed of novation with Chiene + Tait and TIAA. We have met with the TIAA Audit Director, who confirmed that TIAA will continue to operate under the Chiene + Tait methodology for the NGS internal audit.

**20.** We are adopting a largely substantive approach to our audit. As such, we will not place formal reliance on the work of internal audit to support our audit opinion on the financial statements. Having reviewed the Internal Audit Plan, we plan to consider Internal Audit's work on IT Security and Business Continuity Management in respect of our wider dimension audit responsibilities.

## National Fraud Initiative (NFI)

**21.** NFI is a data-matching exercise led by Audit Scotland to aid the detection of fraudulent payments. NFI allows public bodies to investigate matches and, if fraud or error has taken place, to stop payments and attempt to recover the amounts involved. It also allows auditors to assess the arrangements that the bodies have put in place to prevent and detect fraud, including how they approach the NFI exercise itself.

**22.** The current data matching exercise collected data in October 2016 and match investigation work began in January 2017. NGS is required to carry out its own investigation of data matches, as the organisation uses various financial systems which are independent from Scottish Government systems. We will monitor participation and progress with the NFI exercise and complete an audit questionnaire which will reflect the activity undertaken by NGS to June 2017. We will report the outcomes of our review in our Annual Audit Report.

## Audit dimensions

**23.** Our audit is based on four audit dimensions that frame the wider scope of public sector audit requirements as shown in [Exhibit 5](#).

## Exhibit 5

### Audit dimensions



#### Financial sustainability

**24.** As auditors we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on the body's financial sustainability in the longer term. We define this as medium term (two to five years) and longer term (longer than five years) sustainability. We will carry out work and conclude on:

- the effectiveness of financial planning in identifying and addressing risks to financial sustainability in the short, medium and longer term
- the appropriateness and effectiveness of arrangements in place to address any identified funding gaps
- whether NGS can demonstrate the affordability and effectiveness of funding and investment decisions it has made.

#### Financial management

**25.** Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. We will review, conclude and report on:

- whether NGS has arrangements in place to ensure systems of internal control are operating effectively
- whether NGS can demonstrate the effectiveness of budgetary control system in communicating accurate and timely financial performance
- how NGS has assured itself that its financial capacity and skills are appropriate
- whether NGS has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.

#### Governance and transparency

**26.** Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information. We will review, conclude and report on:

- whether NGS can demonstrate that the governance arrangements in place are appropriate and operating effectively
- whether there is effective scrutiny, challenge and transparency on the decision-making and finance and performance reports
- the quality and timeliness of financial and performance reporting.

**27.** An additional area we will cover in our 2016/17 audit is a follow-up review of a previous Audit Scotland national performance audits:

- **The Role of Boards:** This report was published in September 2010. The follow up review will assess NGS's governance, decision-making and scrutiny arrangements.

### Value for money

**28.** Value for money refers to using resources effectively and continually improving services. We will review, conclude and report on the following over our five-year appointment:

- NGS can provide evidence that it is demonstrating value for money in the use of its resources.
- NGS can demonstrate that there is a clear link between money spent, output and outcomes delivered.
- NGS can demonstrate that outcomes are improving.
- There is sufficient focus on improvement and the pace of it.

### Independence and objectivity

**29.** Auditors appointed by Audit Scotland must comply with the Code of Audit Practice. When auditing the financial statements auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has in place robust arrangements to ensure compliance with these standards including an annual “fit and proper” declaration for all members of staff. The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland’s Ethics Partner.

**30.** The engagement lead for National Galleries of Scotland is Asif A Haseeb. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of National Galleries of Scotland.

### Quality control

**31.** International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor’s report or opinion is appropriate in the circumstances.

**32.** The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards Audit Scotland conducts peer reviews, internal quality reviews and is currently reviewing the arrangements for external quality reviews.

# National Galleries of Scotland

## Annual Audit Plan 2016/17

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