

# National Galleries of Scotland

Annual Audit Plan 2017/18



 AUDIT SCOTLAND

Prepared for National Galleries of Scotland

February 2018

## 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 and is carried out in accordance with International Standards on Auditing (ISAs), the [Code of Audit Practice](#), and any other relevant guidance. This plan identifies our audit work to provide an opinion on the financial statements and related matters and meet the wider scope requirements of public sector audit.
2. 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

3. 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 National Galleries of Scotland (“NGS”). We have categorised these risks into financial statements risks and wider dimension risks. The key audit risks, which require specific audit testing, are detailed in [Exhibit 1](#).

## Exhibit 1

### 2017/18 Key audit risks

Audit Risk	Source of assurance	Planned audit work
<b>Financial statements 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>Owing to the nature of this risk, assurances from management are not applicable in this instance.</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. The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud.</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 testing of income and expenditure, focusing on the areas of greatest risk.</p> <p>Audit work on the National Fraud</p>

Audit Risk	Source of assurance	Planned audit work
<p>The Code of Audit Practice expands the ISA assumption to include a risk of fraud over aspects of expenditure for public sector bodies.</p>		<p>Initiative data matches.</p>
<p><b>3 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of non current assets, liabilities (provisions, deferred income and accruals) and donated heritage asset additions.</p> <p>This subjectivity represents an increased risk of misstatement in the financial statements.</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>We will instruct a reputable and qualified surveyor to apply indexation to our properties.</p> <p>We will ensure that there is a sound procedure for the indexation and that this is reflected accurately in the financial statements.</p>	<p>Substantive testing of liabilities and year-end indexation of land and buildings.</p> <p>Substantive testing of liabilities and cut-off testing of income and expenditure.</p> <p>Substantive testing of valuation of donated heritage assets.</p> <p>Review of the work of management's expert valuers.</p> <p>Review of accounting policies to ensure these are reasonable and in line with the accounting framework.</p>
<p><b>4 Heritage Assets</b></p> <p>NGS capitalised £197.9m heritage assets at 31 March 2017. NGS manages its heritage assets using its Mimsy asset register.</p> <p>In our 2016/17 Annual Audit Report, we identified that</p> <ul style="list-style-type: none"> <li>there was not a reconciliation between the capitalised heritage asset valuation and the accounts.</li> <li>it is not possible to obtain a breakdown of heritage assets capitalised in the accounts, with corresponding values.</li> </ul> <p>As such, there is a risk that heritage assets capitalised may have been sold, transferred, lost, stolen or damaged and therefore should no longer be recognised in the Balance Sheet.</p>	<p>We have reconciled a consolidated list of capitalised heritage assets with the Mimsy heritage asset register.</p>	<p>We will assess the arrangements put in place.</p> <p>Substantive testing of the heritage assets balance, including physical verification of a sample of assets.</p>
<p><b>5 NGS Foundation</b></p> <p>NGS prepares group accounts that include its subsidiary company, NGS Trading Company Limited. However, NGS doesn't consolidate its charitable</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</p>	<p>Meet with NGS management to obtain details of its involvement with the Charitable</p>

Audit Risk	Source of assurance	Planned audit work
<p>foundation, National Galleries of Scotland Foundation ("the Foundation") which was created in 2012. In 2016/17, we agreed with management's assessment that no consolidation of the Foundation was required, as NGS didn't exercise control over the Foundation, as defined in the Charities SORP.</p> <p>We will review NGS's relationship with the Foundation in 2017/18 to ensure that this approach remains correct.</p>	<p>NGS. Grants issued by the Foundation are subject to performance conditions.</p>	<p>Foundation in 2017/18.</p> <p>Substantive testing of grant funding provided by the Charitable Trust to NGS.</p> <p>We will correspond with the Foundation's Company Secretary to inform our assessment.</p>

### Wider dimension risks

<p><b>6 Financial sustainability</b></p> <p>NGS has medium-term financial plans in place until 2019/20.</p> <p>However, after the current year, NGS is projecting excess of expenditure over income. The Scottish Government announced lifting of the public sector pay cap, which may impact on NGS's pay policy. The Scottish Government has also announced that pay increases will be implemented in April, rather than August.</p> <p>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>Review budget monitoring and medium term financial plans, following the approval of the 2018/19 budget.</p> <p>Ongoing assessment of NGS's financial plans.</p>
<p><b>7 Cyber Security</b></p> <p>In 2016/17, Internal Audit identified a number of weaknesses in NGS's ICT arrangements.</p> <p>The Scottish Government has issued a Public Sector Action Plan ('Cyber Essentials') which requires all public sector bodies to carry out work in relation to their cyber security arrangements. This will require NGS to carry out a comprehensive assessment and accreditation with Cyber Essentials Plus to demonstrate measures are in place to reduce this risk of cyber attacks.</p>	<p>Action Plan is being implemented following Internal Audit's 2016/17 ICT Review.</p> <p>Ongoing assessment of NGS's cyber security arrangements in line with the Scottish Government's Cyber Essentials plus.</p>	<p>Monitor ongoing work within the IT department to ensure the Public Sector Action Plan is being followed.</p> <p>Assess NGS's progress in updating Disaster Recovery and Business Continuity plans in respect of IT.</p> <p>Review Internal Audit's follow-up of ICT issues.</p>

## Reporting arrangements

4. 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).
5. 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 the relevant officer(s) to confirm factual accuracy.
6. We will provide an independent auditor's report to NGS, Scottish Parliament and the Auditor General for Scotland setting out our opinions on 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.

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## Exhibit 2

### 2017/18 Audit outputs

Audit Output	Target date	Audit & Risk Committee Date
Annual Audit Plan	28 February 2018	27 February 2018
National Fraud Initiative Return	28 February 2018	n/a
Annual Audit Report	10 August 2018	4 September 2018
Independent Auditor's Report	30 September 2018	Following Board on 10 September 2018

## Audit fee

7. The audit fee for the 2017/18 audit of NGS is £22,560 (2016/17 £22,220). 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 22 June 2018 (See Exhibit 4 below).
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 & 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 (including supplementary guidance) and guided by the auditing profession's ethical guidance.
  
- 12.** Auditors in the public sector give an independent opinion on the financial statements and other specified information accompanying the financial statements. We also review and report on the arrangements within NGS 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
- assessing the key systems of internal control, and establishing how weaknesses in these systems could impact on the financial statements
- 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 NGS 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 Trustees' Annual Report and the results in the financial statements
- the consistency of the governance statement.



characteristics



responsibilities



principal activities



risks



governance arrangements

## Materiality

**15.** We apply the concept of materiality in planning and performing the audit. It is used in evaluating the effect of identified misstatements on the audit, and of any uncorrected misstatements, on the financial statements and in forming our opinion in the auditor's report.

**16.** 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
<p><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 2017 based on the latest audited accounts. We have used total assets as the basis for calculating materiality, as a primary function of NGS is to operate as a custodian of public assets. This treatment is in line with ISA 320 and Practice Note 10: Audit of Financial Statements of Public Sector Bodies in the United Kingdom.</p>	£3.340 million
<p><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.</p>	£1.670 million
<p><b>Reporting threshold (i.e. clearly trivial)</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.</p>	£33,000

17. We review and report on other information published with the financial statements including the Trustees’ Annual Report and the Governance Statement. Any issue identified will be reported to the Audit & Risk Committee.

#### Timetable

18. 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 & Risk Committee dates.

## Exhibit 4

### Financial statements timetable

 Key stage	 Date
Latest submission date of unaudited Trustees’ Annual Report and Financial Statements with complete working papers package	22 June 2018
Latest date for final clearance meeting with Chief Operating Officer, Head of Finance and Financial Controller	12 July 2018
Latest date for issue of draft Annual Audit Report, including ISA 260 requirements	20 July 2018
Latest date for management comments on factual accuracy of draft Annual Audit Report	8 August 2018
Agreement of audited unsigned Trustees’ Annual Report and Financial Statements; Issue of Annual Audit Report, including ISA 260 requirements	10 August 2018

Presentation of our Annual Audit Report, including ISA 260 requirements, to Audit & Risk Committee	4 September 2018
Approval of the Trustees' Annual Report and Financial Statements by the Board of Trustees	10 September 2018
Independent auditor's report signed	11 September 2018

## Internal audit

- 19.** 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 as part of our planning process we carry out an assessment of the internal audit function. Internal audit is provided by TIAA overseen by Gill Callaghan, Director of Audit.
- 20.** We will undertake a formal review of the work of Internal Audit in Spring 2018 and report the findings in our Annual Audit Report.
- 21.** 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.
- 22.** In respect of our wider dimension audit responsibilities we plan to consider other areas of internal audit work including:
- Risk Management
  - Acquisition and Loans
  - Capital Projects
  - Development
  - Follow-up of ICT Report

## Information security

**23.** In relation to the General Data Protection Regulation (GDPR), the new legislation takes effect for all public sector bodies in May 2018. NGS should ensure they have plans in place to comply with GDPR. Failure to comply with new data handling arrangements could potentially result in NGS incurring fines. Information security arrangements should therefore be closely examined to plan for GDPR implementation.

## National Fraud Initiative (NFI)

**24.** 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.

**25.** The current data matching exercise collected data in October 2016 and match investigation work began in January 2017. The Scottish Government (SG) finance directorate investigate relevant data matches on behalf of NGS, due to the shared SG finance and payroll systems used. We will monitor the progress and outcomes

of the NFI exercise throughout the audit process and report relevant conclusions in our Annual Audit Report.

## Audit dimensions

26. 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



Source: Code of Audit Practice

### Financial sustainability

27. 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 short term (less than two years), 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

28. 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

**29.** 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

### Value for money

**30.** Value for money refers to using resources effectively and continually improving services. We will review, conclude and report on whether:

- 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

**31.** Auditors appointed by the Auditor General or Accounts Commission must comply with the Code of Audit Practice and relevant supporting guidance. 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 Director of Audit Services, who serves as Audit Scotland’s Ethics Partner.

**32.** The appointed auditor for NGS 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 NGS.

### Quality control

**33.** 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.

- 34.** 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 (and relevant supporting guidance) 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.
- 35.** As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time and this may be directed to the engagement lead.

## **Adding Value**

- 36.** Through our audit work we aim to add value to NGS. We will do this by ensuring our Annual Audit Report provides a summary of the audit work done in the year together with clear judgements and conclusions on how well NGS has discharged its responsibilities and how well it has demonstrated the effectiveness of its arrangements. Where it is appropriate we will recommend actions that support continuous improvement and summarise areas of good practice identified from our audit work.

# National Galleries of Scotland

## Annual Audit Plan 2017/18

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
T: 0131 625 1500 E: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)