

The Scottish Housing Regulator

Report on the 2008/09 Audit

October 2009



 AUDIT SCOTLAND



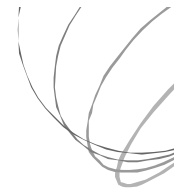
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Key messages

In 2008/09 we looked at the key strategic and financial risks being faced by The Scottish Housing Regulator (SHR). We audited the financial statements and we also reviewed the use of resources and aspects of performance management and governance. This report sets out our key findings.

Financial statements

We have given an unqualified opinion on the financial statements of SHR for 2008/09. We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

Financial position and use of resources

SHR achieved a net underspend of £667,000 million in 2008/09. This is the difference between the operating costs for the period of £3.908 million and the budget set by the Scottish Government of £4.575 million. The primary reason for the under spend was due to reduced staff costs arising from vacancy rates in the first year of operation.

Scottish Ministers have agreed a resource budget of £4.682 million for 2009/10, which includes 2% year on year efficiency savings. With staff costs accounting for approximately 80% of the budget, SHR will need to manage staff costs as vacancies are filled.

The financial settlement for 2009 to 2012 will be expected to support delivery of reforms arising from the Housing Bill, the Crerar Review and the provisions of the Public Sector Reform Bill, in addition to supporting SHR's normal business.

Governance and accountability

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. SHR was established in 2008 and efforts have focused on establishing corporate governance and control arrangements. SHR has established a range of controls and overall the corporate governance and control arrangements for SHR operated satisfactorily during the year, as reflected in the Statement on Internal Control.

We examined the key financial systems which underpin the organisation's control environment. We concluded that financial systems and procedures operated sufficiently well to enable us to place reliance on them.



Performance

SHR agreed its corporate plan for 2008 – 2010 with Scottish Ministers in September 2008. The plan focuses on six strategic objectives. Priorities for 2008/09 included recruiting key posts and establishing systems of corporate governance and performance management. Inspection work has moved away from cyclical inspections to a new risk-based methodology and SHR is working in partnership with other scrutiny bodies on a shared risk assessment of local authorities. The 2008/09 business plan included over 100 targets and 75% of the targets were achieved or related to on-going activity, with the Executive Management Team reviewing and rescheduling the remaining targets.

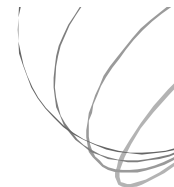
Looking forward

The final part of our report notes some key risk areas and issues for SHR going forward, including the Housing Bill, scrutiny co-ordination and financial pressures on the housing sector. We also highlighted a number of national issues which affect all public sector bodies including the review of data handling arrangement in public bodies across Scotland. We will continue to monitor developments in these areas.

The assistance and co-operation given to us by Board members and staff during our audit is gratefully acknowledged.



October 2009



Introduction

1. This report summarises the findings from our 2008/09 audit of SHR. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 19 March 2009. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. The results from our internal control testing were reported to the Audit Committee in June 2009 and SHR is addressing the issues raised in the action plan.
3. Best value duties apply across the public sector and, in central government, best value is a formal duty on all accountable officers. Audit Scotland has adopted a generic framework for the audit of best value across the public sector and throughout this report we comment on aspects of SHR's arrangements.

Exhibit 1: Framework for a best value audit of a public body

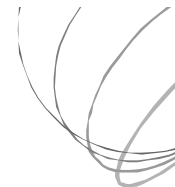




4. Our comments are made on the basis of information made available in the course of the annual audit. We do not make an overall best value judgement because we do not have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time. This report is the first step towards that goal.

5. Another building block for our assessment of best value is the national study programme carried out by Audit Scotland on behalf of both the Auditor General for Scotland and the Accounts Commission. We mention the key findings from all relevant reports, and the implications for SHR, throughout this report. Full copies of the study reports can be obtained from Audit Scotland's website, www.audit-scotland.gov.uk.

6. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by management and members of SHR during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website.



Financial Statements

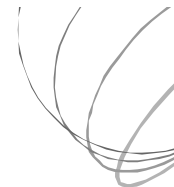
7. In this section we summarise key outcomes from our audit of SHR's financial statements for 2008/09 and the accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

8. We audit the financial statements and give an opinion on:
- whether they give a true and fair view of the financial position of SHR and its expenditure and income for the period in question
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
 - the consistency of the information which comprises About Us, performance against our strategic objectives and the management commentary, with the financial statements
 - the regularity of the expenditure and receipts.
9. We also review the statement on internal control by:
- considering the adequacy of the process put in place by the Chief Executive as Accountable Officer to obtain assurances on systems of internal control
 - assessing whether disclosures in the statement are consistent with our knowledge of SHR.

Overall conclusion

10. We have given an unqualified opinion on the financial statements of SHR for 2008/09.
11. As agreed, the unaudited accounts were provided to us on 26 May 2009, supported by a working paper package. We concluded our audit within the agreed timetable and provided our opinion to the Audit Committee on 26 June 2009 as timetabled.



Issues arising from the audit

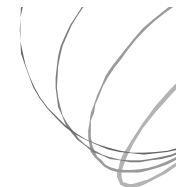
12. As required by auditing standards we reported to the audit committee on 30 June 2009 on the main issues arising from our audit of the financial statements. The key issues were as follows:
13. **Accommodation charges** – SHR lease accommodation in Glasgow from the Scottish Government under a Memorandum of Terms of Occupancy (MOTO). SHR is liaising with the Scottish Government on obtaining improved information from the landlord to assist them monitor rent, rates and service charges against signed agreements.
14. **Fixed asset additions** –The accounts presented for audit did not include any fixed asset additions. Audit work confirmed assets had been brought into use during the year but as they were below the capitalisation threshold, both individually and collectively, the accounts did not require them to be treated as fixed asset additions. The fixed asset register was updated during the year, although there were no formal procedures in place. SHR is establishing formal protocols for bringing assets into use and updating the fixed asset register on a regular basis.

Regularity

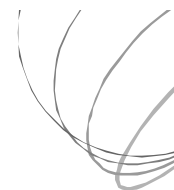
15. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to her view on adherence to enactments and guidance. No significant issues were identified for disclosure.

International financial reporting standards (IFRS)

16. As announced by the Chancellor in the 2008 Budget report on 12 March 2008 (Budget report paragraph C103), Government departments and other public sector bodies will report using International Financial Reporting Standards (IFRS) from 2009/10. The Scottish Government announced on 25 April 2008 that all Scottish Government Departments, Executive Agencies, Health Bodies and Non-Departmental Public Bodies would be required to produce shadow IFRS based accounts for financial year 2008/09. This was to include a restated balance sheet as at 1 April 2008.



17. In terms of the audit of the IFRS opening balance sheet at 1 April 2008, there were two key dates to achieve as outlined below:
 - **28 November 2008** – opening 2008 IFRS-based balance sheet were to be presented to auditors for dry-run audit
 - **28 February 2009** – dry-run audit of opening balances was to be completed, resulting in a letter to management highlighting the work done, auditors' findings and areas for further work.
18. SHR had not been provided with any information on assets transferred from Communities Scotland and had been liaising with the Scottish Government on obtaining information on annual leave. SHR was therefore unable to meet the deadline date of 28th November 2008 to present the opening balance sheet and supporting evidence. Resources on IFRS work were constrained as priorities for SHR in 2008 were to recruit key posts and establish finance systems, controls and procedures.
19. We made some recommendations for the delivery of the next stage of IFRS reporting – the production of the shadow accounts for 2008/09, and will consider progress on these when we review the shadow accounts later in 2009. These included:
 - to review the accommodation, Highlander House, to assess whether it is an operating or finance lease
 - to review intangible assets to ensure treatment follows IFRS
 - to consider the adequacy of annual leave accrual information from the Scottish Government
 - to collect flexitime balances at the year-end and to assess whether this is material.
20. SHR provided draft 2008/09 shadow IFRS accounts in September 2009 for audit and we will audit these accounts in due course.



Use of Resources

21. Sound management and use of resources (people, money and assets) to deliver strategic objectives is a key feature of best value. This section sets out our main findings from a review of SHR's:

- financial position
- financial management.

Financial Position

Outturn 2008/09

22. SHR is required to work within its resource budget set by the Scottish Government. SHR achieved a net under spend of £667,000 in 2008/09. This is the difference between the operating costs for the period of £3.908 million and the budget set by the Scottish Government of £4.575 million. After quarter 3, SHR identified they would not spend the full budget so returned £0.229 million to the Scottish Government, giving a revised budget of £4.346 million. Outturn against the revised budget resulted in an under spend of £438,000. The primary reason for the under spend was due to reduced staff costs arising from vacancy rates in the first year of operation.

Exhibit 2 – Performance against resource budget 2008/09 (£ million)

Limits	Original budget	Revised budget	Actual Outturn
Operating	4.575	4.346	3.908
Capital	nil	nil	nil
Total	4.575	4.346	3.908

Financial sustainability and the 2009/10 budget

23. Scottish Ministers have agreed a resource budget for SHR of £4.682 million for 2009/10 as set out below:

Exhibit 3 – 2008/09 Resource Plan

Limits	Budget
	£million
Operating	4.682
Capital	Nil
Total	4.682



24. Two percent efficiency savings are built into the budgets of SHR and current projections forecast expenditure to be within budget in 2009/10. The financial settlement for 2009 to 2012 will be expected to support delivery of reforms arising from the Housing Bill, the Crerar Review and the provisions of the Public Sector Reform Bill, in addition to supporting SHR's normal business. Providing services and supporting delivery of reforms, while absorbing pay inflation and other cost pressures (including accommodation and ICT costs), represents a challenge for the organisation.
25. SHR is unlikely to undertake large capital projects, given the nature of the organisation and its activities.

National Studies

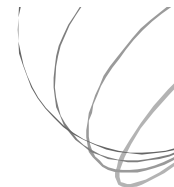
26. Audit Scotland published one national study relevant to SHR's use of resources: *Use of consultancy services*. A summary of the report is provided below. Copies of the full report can be downloaded from our website at www.audit-scotland.gov.uk.

Use of consultancy services

27. The overall aim of the study was to review central government's use of consultancy services and to make recommendations to improve the public sector's use of consultants' knowledge, skills and resources to help deliver new services and initiatives quickly and expertly. The key findings were as follows:
 - The public sector is strengthening the way it buys goods and services.
 - Central government does not have a clear strategy for its use of consultants or for linking use to its priorities or financial and workforce plans.
 - In most cases, central government buys consultancy services well but some improvements can be made.
 - Central government could improve how it manages consultancy projects through more consistent and formal evaluation of consultants' work and learning more from them.
 - Central government could make savings of up to £13 million a year through better planning and buying of consultancy services.



28. The report made specific recommendations for public bodies; they should:
- confirm they have clear processes for approving and recording the use of consultants and monitoring progress, and reinforce these as required
 - plan their use of consultancy services when developing their forward work programme to ensure that consultants are used where their knowledge and skills bring greatest value for money
 - always evaluate the option to use consultants against the option to use their own staff
 - gather and share consistent information on the consultancy skills bought and why consultants are used
 - increase the use of framework agreements where possible by ensuring that existing agreements are used and new ones developed as appropriate
 - select and use the most economical competition routes by using framework agreements, restricted competitions and closed tendering approaches when appropriate
 - evaluate the work of consultants more systematically and share findings from these reviews
 - work closely with consultants to increase assurance on quality and make use of opportunities to learn from consultants and ensure knowledge transfer, where appropriate.
29. SHR engages consultants to primarily support their inspection and business analysis work. SHR uses procurement procedures operated by the Scottish Government and the Audit Committee reviews contracts issued outwith the competitive tender process.



Governance and Accountability

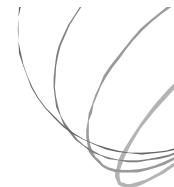
30. High standards of governance and accountability, with effective structures and processes to govern decision-making and balanced reporting of performance to the public, are fundamental features of best value. This section sets out our findings arising from a review of SHR arrangements.
31. Increasingly services are being delivered across the public sector through partnership working, sometimes involving complex governance and accountability arrangements. Best value characteristics also include effective partnership working to deliver sustained improvements in outcomes.

Overview of arrangements

32. This year we reviewed:
 - key systems of internal control
 - internal audit
 - arrangements for the prevention and detection of fraud and irregularity, including standards of conduct.
33. Our overall conclusion is that SHR made good progress in establishing systems of internal control during its first year of operation.

Systems of internal control

34. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In their annual report for 2008/09 Scottish Government Internal Audit, the internal auditors, provided their opinion that, based on the internal audit work undertaken during the year, there was substantial assurance on the adequacy and effectiveness on the systems of internal controls.
35. As part of our audit we reviewed the controls in a number of SHR systems that impact on the financial statements and for 2008/09 this audit work covered payroll and accounts payable systems. Our overall conclusion was that key controls were operating effectively and that SHR has adequate systems of internal control in place. We did identify a number of areas where controls could be strengthened and agreed an action plan of improvements with management. This will be followed up in 2009 to confirm that improvements have been made.



36. We also rely on assurances received from the auditor of the Scottish Government on work performed on shared systems that operate at SHR, hosted by the Scottish Government. This supports our approach to deliver an audit without unnecessary duplication.
37. The shared systems assurance letter provided by the auditor of the Scottish Government concluded that there was adequate assurance for all systems except payroll. Adequate assurance is where key controls and procedures are operating to enable reliance to be placed on the system. Limited assurance was provided for the payroll system operated by the Scottish Government and we therefore carried out additional work locally to achieve our audit objectives. There is no impact on our overall audit opinion on the financial statements.

Statement on Internal Control

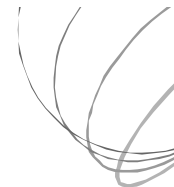
38. The Statement on Internal Control (SIC) provided by SHR's Accountable Officer reflected the main findings from both external and internal audit work. The SIC recorded management's responsibility for maintaining a sound system of internal control and sets out their approach in meeting these responsibilities.

Internal Audit

39. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2008/09 audit we assessed whether we could place reliance on SHR internal audit function. We concluded that Scottish Government Internal Audit operates in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in a number of areas during 2008/09, as we anticipated in our annual audit plan. This included reliance on aspects of internal audit's systems work to avoid duplication of effort.

Prevention and detection of fraud and irregularities

40. SHR has appropriate arrangements in place to prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and Board members.



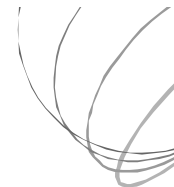
Performance

41. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. Key features of best value include:
- setting a clear vision of what the organisation wants to achieve, backed up by plans and strategies to secure improvement, with resources aligned to support their delivery
 - a performance management culture which is embedded throughout the organisation and a performance management framework which is comprehensive and supports the delivery of improved outcomes.
42. In this section we comment on:
- SHR's corporate plan
 - Public Sector Reform Bill
 - scrutiny co-ordination
 - performance overview.

Vision and strategic direction

Corporate Plan

43. SHR agreed its corporate plan for 2008 – 2010 with Scottish Ministers in September 2008. The plan focuses on six strategic objectives:
- to hold regulated bodies to account for securing better service outcomes
 - to provide assurance about the financial viability of Registered Social Landlords (RSLs) and challenge all landlords to deliver better asset management and value for money
 - to secure good governance and accountability
 - to engage tenants and other service users in our work
 - to inform, and respond to, the Scottish Government's policy and investment priorities
 - to be a responsive and best value organisation.



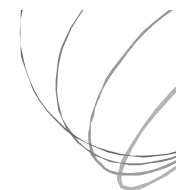
44. SHR has developed a new risk-based approach to regulation which incorporates an annual regulatory assessment of RSLs and has ended cyclical inspections of RSLs. RSLs have been operating in a challenging financial climate with pressures on obtaining finance. In addition to the annual financial review of RSLs, SHR carried out further work e.g. examining RSL business plans and surveying RSLs on how they were addressing financial issues, allowing SHR to better understand the sector. Also SHR, along with various stakeholders, carried out insolvency scenario testing to test possible responses to the financial collapse of an RSL. This followed SHR's internal review of its practices against the findings and recommendations of an independent inquiry that had reported on the insolvency of an English housing association.

Public Sector Reform Bill

45. The Public Sector Reform Bill is a collection of measures to reform the public sector landscape in Scotland including some proposals arising from the Crerar Review. The Bill proposes to abolish a number of bodies, merge some and create new bodies. It also has provisions aimed at improving scrutiny co-ordination and involving users in scrutiny. There are also proposals to enable future reforms to be undertaken using statutory instruments rather than requiring primary legislation.
46. The Bill also contains provisions requiring listed bodies (including SHR) to co-operate and co-ordinate activity with each other and, where appropriate, the Scottish Ministers with a view to improving the exercise of scrutiny functions in relation to local authorities, social services and health services having regard to economy, efficiency and effectiveness. We will monitor developments in 2009/10.

Scrutiny Co-ordination

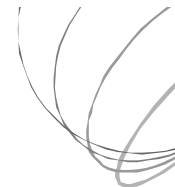
47. Following the publication of the Crerar Review in September 2007, the Scottish Government's response stated its aim of establishing a simplified and coherent approach to delivering local government scrutiny. A key aspect of this agenda is to better coordinate and streamline scrutiny and achieve greater effectiveness, whilst at the same time protecting the independence of scrutiny bodies.
48. In February 2008, the Accounts Commission was asked to take on the transitional gatekeeping role in respect of the scrutiny of local government. The local government scrutiny coordination strategic group was established to set priorities and oversee development activity. The following key priorities were subsequently agreed:
- Improving the planning and scheduling of scrutiny activity.
 - Developing a single corporate assessment.
 - Implementing a shared risk assessment framework.



49. The strategic group established an operational group to carry out the necessary detailed work in respect of these priorities. The group is made up of representatives from SHR and other scrutiny bodies including Social Work Inspection Agency, NHS QIS, Care Commission, HM Inspectorate of Education, COSLA and Audit Scotland.
50. The recent update on progress of the group has noted that:
- The first joint scrutiny plan for local government in Scotland has been published and covers the period from April 2009 until March 2010. This is a key milestone in the transitional arrangements set out for 2009.
 - The joint scrutiny schedule also sets out the various ways in which local government audit, inspection and regulatory bodies in Scotland have already adopted more proportionate and risk-based approaches to scrutiny when exercising their statutory functions. The group's analysis indicates that taken together these developments should lead to a significant reduction in the overall level of scrutiny experienced by local government – estimated to be in the region of 25%.
 - The implementation of shared risk assessment arrangements are progressing and current activity aims to establish an earlier joint local scrutiny presence from which shared risk assessment work will be led and further developed for the future.
51. We will continue to monitor the impact of these developments on SHR.

Performance overview

52. The Annual Report and Accounts provide details of performance against SHR's six strategic objectives as outlined at paragraph 42. The report shows that SHR had to respond to the difficult financial pressures experienced by RSLs as they managed funding from lenders during the economic downturn. SHR provided briefings to the sector on financial viability and continued to liaise with tenant groups. Where necessary, SHR made external Board appointments to RSLs to provide skills and experience during periods of significant change or difficulty.
53. The 2008/09 business plan analysed SHR's six strategic objective into 39 detailed objectives, with each objective having one or more target. In total there were over 100 targets. Many of the targets related to SHR recruiting specific posts and establishing governance arrangements in the first year. In May 2009 the Regulation Board were updated on progress that 75% of the targets were achieved or related to on-going activity and the Executive Management Team were reviewing and rescheduling the remaining targets. We will continue to monitor targets and outcomes in 2009/10.

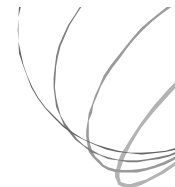


Risk management

54. Internal audit reviewed governance and risk management arrangements at SHR and concluded that considerable progress had been made in establishing risk management framework and the register was regularly reviewed by the Executive Management Team and the Regulation Board. Internal audit made recommendations on embedding a risk management culture across the organisation.
55. High level risks identified relate to the changing scrutiny environment, workforce planning and SHR's response to failing RSLs and SHR has actions in place to manage these risks.

Efficiency

56. Two percent efficiency savings are built into the budgets of SHR. Delays in recruitments in 2008/09 resulted in under-spends against budget and the challenge for SHR in the future is to review activities to identify efficiencies as operating with vacancy levels may be unsustainable in the longer term.



Looking Forward

57. SHR faces a number of challenges in 2009/10, which include:

- **Housing Bill** - The Scottish Government is developing a bill to modernise the legislative basis for regulation. SHR has commented on draft policy instructions and continues to work closely with the Scottish Government. The bill is being currently being revised following a period of consultation and the outcome of the bill will significantly influence the future direction of SHR. The bill is not expected to be introduced to Parliament until 2010.
- **Scrutiny Co-ordination** – 2009/10 is the first year of the joint scrutiny plan for local government in Scotland. Implementation of the shared risk assessment arrangements progresses and we will continue to monitor the impact of these developments on SHR.
- **Efficiencies and future funding** - Budgets for 2009/10 and the immediate future will need to be managed within a tighter funding regime and SHR will need to consider the outcomes of legislative changes and current staffing levels. SHR will come under increasing pressure to identify efficiencies and review future commitments to ensure delivery of key targets and objectives.
- **Financial pressures on housing sector** – in 2008/09 SHR tailored its regulatory work in response to the challenging financial climate for RSLs. As financial pressures continue for the housing sector (from banking and the public sector) it will be a challenge for SHR to manage its workload and resources to regulate RSLs.
- **Data handling** – The Scottish Government carried out a review of data handling arrangements in Scotland during 2007. The review considered current policies and procedures on data protection, consistency with government standards and local arrangements for implementation of procedures. A report published in June 2008 made recommendations for a higher level of oversight and guidance from the Scottish Government and improved security of sensitive information. We will monitor SHR's progress against recommendations due to be implemented during 2009/10.
- **Performance Management** - During 2008/09 SHR developed their approach to a performance management framework and trialled the balanced scorecard approach. However, SHR have now decided that the complexity of the approach outweighs its practical use and are reviewing alternative approaches. We will monitor developments in 2009/10.
- **National Performance Framework** - The Scottish Government is continuing to develop its approach to performance management based on the National Performance Framework and local authority single outcome agreements. The National Performance Framework is an outcome-based approach that is publically reported on the Scottish Government's web site in



the 'Virginia-style' model of performance measurement and reporting. This will include progress on overall delivery of the administration's purpose for Government, the five strategic objectives for Scotland and other aspects of the outcomes based National Performance Framework.

- **Best Value** – Best value duties apply across the public sector and, in central government, best value is a formal duty on all accountable officers. SHR's sixth strategic objective is to be a responsive and best value organisation and the priorities for SHR for 2008/09 were to establish governance arrangements for the new body. A challenge for SHR is to consider how they can demonstrate overall that arrangements have been made to secure best value.