

The Scottish Housing Regulator

Annual report on the 2010/11 audit



Prepared for The Scottish Housing Regulator and the Auditor General for Scotland
November 2011

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Key messages

2010/11

We have given an unqualified opinion on the financial statements of SHR for 2010/11. 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.

SHR achieved a net underspend of £48,000 in 2010/11. This is the difference between the operating costs for the period of £4.282 million and the budget set by the Scottish Government of £4.330 million. SHR funded early severance costs of £430,000 within their 2011/12 budget.

SHR has worked with the Scottish Government for the past two years preparing for the Housing (Scotland) Act 2010 and then assessing the impact of SHR's status changing from an executive agency to a non-ministerial department, with a new SHR Board consisting of members appointed by Ministers. In 2010/11 SHR managed the change process through a transition plan, which detailed SHR's key activities and progress reviewed by the executive management team and Regulation Board.

From October 2009 Michael Cameron was acting Chief Executive and in May 2011 he was appointed as Chief Executive of the agency, and Chief Executive designate of the new Regulator. This provides continuity of leadership during the period of transition towards SHR becoming a non ministerial department.

Outlook

Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. There will be limited increases in funding, increasing cost pressures and challenging savings targets. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight.

The arrangements which SHR has to manage in 2011/12 are complex: the new Board was established as a body corporate on 1 April 2011 to run as a separate accountable organisation but in parallel with the SHR agency, until becoming a non-ministerial department in April 2012. Between April 2011 and April 2012 the new body corporate will consult on the new powers of the Housing (Scotland) Act 2010 whilst the SHR agency continues to operate the Housing (Scotland) Act 2001 powers.

Scottish Ministers have allocated funding of £4.21 million to SHR for 2011/12. In addition to its main activities the 2011/12 budget also has to support the new SHR Board during the transitional year, including paying Board remuneration and consultation costs. Budget planning to date shows that SHR can fund these additional costs out of the 2011/12 budget.

Introduction

1. This report is the summary of our findings arising from the 2010/11 audit of Scottish Housing Regulator (SHR). The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.
2. Reports have been issued in the course of the year (**Appendix A**) and we do not repeat all of the findings in this report, but instead we focus on the financial statements.
3. **Appendix B** is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that SHR understands its risks and has arrangements in place to manage these risks. The Board and Accountable Officer should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.
4. This report is addressed to SHR and the Auditor General and should form a key part of discussions with audit committees, either prior to, or as soon as possible, after the formal completion of the audit of the financial statements. Reports should be made available to stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.
5. This report will be published on our website after consideration by SHR's Audit Committee.
6. The management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to our attention during their normal audit work, and may not be all that exist. 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.

Financial statements

7. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
8. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
 - the regularity of the expenditure and income (except for local government bodies).
9. Auditors review and report on, as appropriate, other information published with the financial statements, including the management commentary, statement on internal control and the remuneration report. Where required, auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit on the financial statements.

Audit opinion

10. We gave an unqualified opinion that the financial statements of SHR for 2010/11 give a true and fair view of the state of the body's affairs and of its excess of comprehensive expenditure over income for the year.
11. SHR is required to follow the 2010/11 Government Financial Reporting Manual (the FReM) and we confirm that the financial statements have been properly prepared in accordance with the FReM.

Going concern

12. As at 31 March 2011 SHR has a net liability on the statement of financial position of £0.402 million (£0.168 million as at 31 March 2010). This has arisen as a result of the requirement to account for the activities of the SHR on an accruals basis, while recording funding from the Scottish Government on a cash basis. As described in the accounting policies, the financial statements have been prepared on a going concern basis as the Accountable Officer has no reason to believe that the support of the sponsor department will not be forthcoming.

Regularity

13. In accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000, we have also provided an opinion, that in all material respects, the expenditure and receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

Remuneration report and statement on internal control

14. In our opinion, the audited part of the remuneration report has been properly prepared and is consistent with the financial statements.
15. We also confirm that we have no issues to report to you on the statement of internal control and its compliance with guidance.

Accounting issues

Accounts submission

16. The financial statements and working papers were submitted for audit on 13 May, in accordance with a pre-agreed timetable. Matters arising were discussed on a regular basis during the course of the audit. The final clearance meeting was on 9 June with the Head of Policy and Corporate Services and staff involved in preparing the annual report and accounts.

Presentational and monetary adjustments to the unaudited accounts

17. A small number of presentational changes were required to the annual report and accounts as a result of our review of the disclosures required by the FReM and the audited financial statements have been reflected to adjust this.

Prior year adjustments

18. All central government bodies have been affected by the removal of the cost of capital in the 2010/11 FReM. This change is identified in the accounting policies and appropriate amendments have been made to the prior year statements.

Whole of government accounts/ consolidation packs

19. The whole of government accounts (WGA) is the consolidated financial statements for all branches of government in the UK. Most central government bodies are required to provide information to their auditors by 29 July however Scottish Government agencies are expected to provide consolidation information for the Scottish Government consolidated accounts by mid-July. SHR submitted its pack to Audit Scotland for audit on 24 May and we have no significant issues to report. We submitted our Consolidation Certificate to the Scottish Government on 29 July, just after the accounts were signed. In addition agencies are also required to submit a WGA consolidation pack. Auditors need only audit WGA returns from bodies that have gross assets, gross liabilities, or gross income (including grant in aid) or gross expenditure of more than £50 million. As the SHR's assets, liabilities, income and expenditure fall below the threshold no audit is required.

Outlook

20. The main change in the financial reporting framework (FReM) next year (2011/12) is that grants and donated assets should be recognised immediately, unless there is a condition that

the recipient had not satisfied that would lead to repayment. This is unlikely to have much (if any) impact on SHR.

21. Looking further ahead, from 1 January 2013 changes to international financial reporting standards (IFRSs) will become effective. This includes the introduction of:
- IFRS 9 - financial instruments (replacing IAS39)
 - IFRS 10 - consolidated financial statements (replacing IAS27)
 - IFRS11 - joint arrangements (replacing IAS31)
 - IFRS12 - disclosure of interest in other entities (replacing IFRS12)
 - IFRS 13 - fair value.
22. Revisions to the FReM for 2013/14 are included in the Financial Reporting Advisory Board (FRAB) forward work programme for 1 December 2011.

Audit appointment for 2011/12

23. Audit appointments are made by the Auditor General, either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment. The procurement process for the next five years was completed in May 2011. From next year (2011/12) the auditor for SHR will be the Auditor General for Scotland. As Audit Scotland will be appointed as the auditor for SHR we look forward to continuing the good working relationship that exists and thank officers and members of the board and audit committee for their assistance during the last three years. We recently met with the incoming audit team as part of a managed changeover process.

Financial position

24. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
25. Auditors consider whether audited bodies have established adequate arrangements and examine:
 - financial performance in the period under audit
 - compliance with any statutory financial requirements and financial targets
 - ability to meet known or contingent, statutory and other financial obligations
 - responses to developments which may have an impact on the financial position
 - financial plans for future periods.
26. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results 2010/11

27. SHR is required to work within its resource budget set by the Scottish Government. SHR reported a net underspend of £48,000 in 2010/11. This is the difference between the operating costs for the year of £4.282 million and the budget set by the Scottish Government of £4.33 million.

Budgetary control

28. SHR's executive management team review budgets monitoring reports on a monthly basis and the Regulation Board is updated on outturn to budget position at its quarterly meetings. d. During 2010/11 SHR identified savings in their budget and were able to fund early departure costs within their £4.33 million budget.

Workforce reduction

29. As a result of the UK Comprehensive Spending Review published in 2010, the Scottish Government committed to a spending plan to 2011-12. A reduction in staffing numbers was regarded as an essential part of the commitment to deliver planned savings by 2012. Staff working in government departments, and agencies, were therefore offered an opportunity to depart early during 2010/11 under one of four schemes.
30. Staff at SHR were therefore eligible to apply for early departure under the Scottish Government Scheme. SHR incurred costs of £430,000 on exit packages as noted in the Annual Report and Accounts.

Financial position at 31 March 2011

31. The Statement of Financial Position shows a net liability position of £0.402 million at 31 March 2011 (net liability of £0.168 million at 31 March 2010). This movement of £0.234 million is primarily due to the new provision for early departure costs.
32. The deficit on the general fund has arisen of the requirement to accounts for the activities of SHR on an accruals basis, whilst recording funding from the Scottish Government on a cash basis. Net liabilities will be funded by the Scottish Government as they arise and, as noted at paragraph 12, the financial statements were prepared on a going concern basis.

Outlook

2011/12 budget

33. Scottish Ministers have allocated funding of £4.21 million to SHR for 2011/12. The 2010/11 budget was £4.33 million but this included transitional resources. In addition to its main activities the 2011/12 budget also has to support the new SHR Board during the transitional year, including paying Board remuneration and consultation costs. SHR advise that they have carried out budget planning exercises to ensure they can absorb these costs.

Governance and accountability

34. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
35. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.
36. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
 - corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption.
37. In this part of the report we comment on key areas of governance.

Corporate governance

Housing (Scotland) Act 2010

38. During 2010/11 SHR were assessing the impact of the Housing Act with SHR's status changing from an executive agency to a non-ministerial department (NMD), leading to a new Board consisting of members appointed by Ministers. The arrangements which SHR has to manage are complex; the new Board was established as a body corporate on 1 April 2011 to run as a separate accountable organisation but in parallel with the SHR agency, until becoming an NMD in April 2012. Between April 2011 and April 2012 the new body corporate will consult on the new powers of the Housing (Scotland) Act 2010 whilst the SHR agency continues to operate the Housing (Scotland) Act 2001 powers.
39. In 2010/11 SHR managed the change process through a transition plan, which detailed SHR's key activities and progress was reviewed by the executive management team and Regulation Board.

Processes and committees

40. From October 2009 Michael Cameron was acting Chief Executive and in May 2011 he was appointed as Chief Executive of the agency, and Chief Executive designate of the new Regulator. This provides continuity of leadership during the period of transition towards SHR becoming a non ministerial department.

41. The Regulation Board assists the Chief Executive to manage and direct the organisation to ensure that SHR fulfils the aims and objectives set by Scottish Ministers. The role of the Board includes monitoring performance against agreed objectives. The Audit Committee monitors and reviews risk, control and corporate governance and reports to the Regulation Board.

Internal control

42. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, our wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.
43. As part of our risk assessment and planning process we assessed the Scottish Government Internal Audit Division, SHR's internal auditors, and concluded that they operate in accordance with the Government Internal Audit Manual. We were therefore able to place reliance on their work in a number of areas as detailed within our annual audit plan.
44. Our audit approach includes a review of the high level controls operating within SHR's key financial systems. Our overall conclusion from the 2010/11 review was that key controls were operating effectively and that SHR has adequate systems of internal control in place.
45. In their annual report for 2010/11, Scottish Government Internal Audit Division 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 control.
46. In the interests of an efficient audit approach 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 approach ensures we are delivering an efficient co-ordinated audit that avoids unnecessary duplication and expense.
47. The Statement on Internal Control (SIC) provided by the SHR's Accountable Officer reflected the main findings from both external and internal audit work. The SIC records management's responsibility for maintaining a sound system of internal control and summarises the process by which the Accountable Officer obtains assurances on the contents of the SIC.

Prevention and detection of fraud and irregularities

48. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Auditors review and report on these arrangements.
49. SHR has appropriate arrangements in place (based on Scottish Government guidance) to prevent and detect instances of fraud and corruption including detailed policies which have recently been reviewed and updated.
50. There were no instances of fraud or corruption reported by SHR in 2010/11.

Standards of conduct and arrangements for the prevention/detection of bribery and corruption

51. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. We have concluded that the arrangements in SHR are satisfactory and we are not aware of any specific issues that we need to identify in this report.

Outlook

52. As noted at paragraph 38 between April 2011 and April 2012 the new body corporate will consult on the new powers of the Housing (Scotland) Act 2010 whilst SHR continues to operate the Housing (Scotland) Act 2001 powers.
53. The transitional arrangements for this year are set out in a Memorandum of Understanding between the Regulator and Scottish Ministers, which explains the agency will provide resources – including staff time- to the Regulator to support its work. SHR are supporting and reporting to two Boards – the new SHR Board and the Regulation Board. In addition the new SHR Board meet more often than the Regulation Board met in previous years; they tend to meet monthly when the Regulation Board met quarterly.
54. With these complex arrangements there is a risk that organisational performance and governance arrangements are affected during the transition year. Progress continues to be monitored by the executive management team through regular update reports against the agency's business plan.

Best Value, use of resources and performance

55. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.
56. The Auditor General may require that auditors consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value. Where no requirements are specified for auditors in a period they may, in conjunction with their audited bodies, agree to undertake local work in this area.
57. As part of their statutory responsibilities, the Auditor General and the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:
 - a performance audit which may result in the publication of a national report
 - an examination of the implications of a particular topic or performance audit for an audited body at local level
 - a review of a body's response to national recommendations.
58. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments.
59. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.
60. This section includes a commentary on the Best Value/ performance management arrangements within SHR. We also note any headline performance outcomes/ measures used by SHR and any comment on any relevant national reports and the body's response to these.

Management arrangements

Best Value

61. In March 2011, the Scottish Government issued new guidance for accountable officers on Best Value in Public Services. The new guidance, in essence, required public bodies to take systematic approach to self-evaluation and continuous improvement.
62. The guidance identifies the themes which an organisation needs to focus on in order to deliver the duty of Best Value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.

63. The five themes and two cross-cutting themes (some of which we have commented on earlier in this report) are:
- vision and leadership
 - effective partnership
 - governance and accountability
 - use of resources
 - performance management
 - equality (cross-cutting)
 - sustainability (cross-cutting).
64. SHR endeavours to implement best value into its operational and corporate activities when reviewing policies and procedures and aspects of the above themes are reflected in the Corporate Plan 2011/12. As 2011/12 is the final year of SHR the focus for the executive team is working with the Board of the new Regulator to develop its future corporate strategy and a new approach to business planning and risk management. To inform that process we recommend that officers review the revised Best Value guidelines and consider self-evaluation to identify areas to be incorporated into the new approach..

Refer Action Plan No 1

Overview of performance in 2010/11

65. SHR agreed its corporate plan for 2010/11 in May 2010. The plan includes six strategic objectives reflecting its main activities:
- 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 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.
66. The Corporate Plan also includes activities SHR planned to achieve to manage the transition to the new Scottish Housing Regulator. These are:
- manage the transition into an organisation fit for its new purpose, reflecting its new status and powers, and ensure that staff are fully engaged in the transition process
 - ensure it is fully prepared for commencement of the new statutory duties and powers
 - continue to regulate effectively through the period of change. Regulation will continue around principles of risk and proportionality.
67. Activities to be carried out to meet the objectives are described in the Corporate Plan 2010/11 along with seven operational performance indicators. The SHR 2010/11 Annual Report and

Accounts provides information under each objective on the range of activities undertaken and outcomes against the performance indicators.

68. The 2010/11 business plan, which is used internally to monitor performance for on-going activity, splits down the objectives and activities per the corporate plan into tasks; 62 in total. Reports to the Regulation Board show that the majority of tasks were complete with only six tasks which are on-going or re-scheduled into 2011/12.

National performance reports

69. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest are set out in Exhibit 1.

Exhibit 1: A selection of National performance reports 2010/11

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| • Scotland's public finances: responding to the challenges | • Role of boards: a summary for non-executive board members |
| • The role of boards | • The cost of public sector pensions in Scotland |
| • Improving energy efficiency: a follow-up report | |

Source: www.audit-scotland.gov.uk

70. SHR Audit Committee discusses national studies, as highlighted by Audit Scotland through progress reports, and how they relate to either SHR itself or the Registered Social Landlord sector. Given the nature of the reports and SHR's small size and specific objectives, SHR did not make changes as a result of these reports to their governance or performance structures.
71. In May 2011 changes to the Scottish Public Finance Manual now require the accountable officer to formally consider a proportionate response to relevant national reports and SHR should consider what processes should be put in place to meet this requirement.

Refer Action Plan No 2

Appendix A: audit reports

External audit reports and audit opinions issued for 2010/11

Title of report or opinion	Date of issue	Date presented to Audit Committee
Annual Audit Plan	7 March 2011	16 March 2011
Report on financial statements to those charged with governance	15 June 2011	22 June 2011
Audit opinion on the 2010/11 financial statements	29 July 2011	n/a

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	64	SHR is working with the Board of the new Regulator to develop its future corporate strategy and a new approach to business planning and risk management. Without a review of refreshed best value guidelines SHR could miss adopting good practice into their revised processes.	We have been considering Best Value guidance as part of our work to prepare for next year. We are looking at how we can adopt Best Value principles and good practice into the new Regulator's future business planning processes.	Corporate Services Manager	31 March 2012
2	71	SHR risk not meeting the requirements of the Scottish Public Finance Manual without putting in place procedures to formally consider a proportionate response to relevant national reports prepared by Audit Scotland.	We will put procedures in place when we are developing our future governance and committee structure. This will be a standing agenda item for the Audit Committee.	Corporate Services Manager	31 March 2012