



 **AUDIT SCOTLAND**

Scottish Housing

Regulator

Annual Audit Report
2014/15

October 2015

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This report will be published on our website after it has been considered by the audit committee. The information in this report may be used by Audit Scotland in any reporting to the Scottish Parliament.

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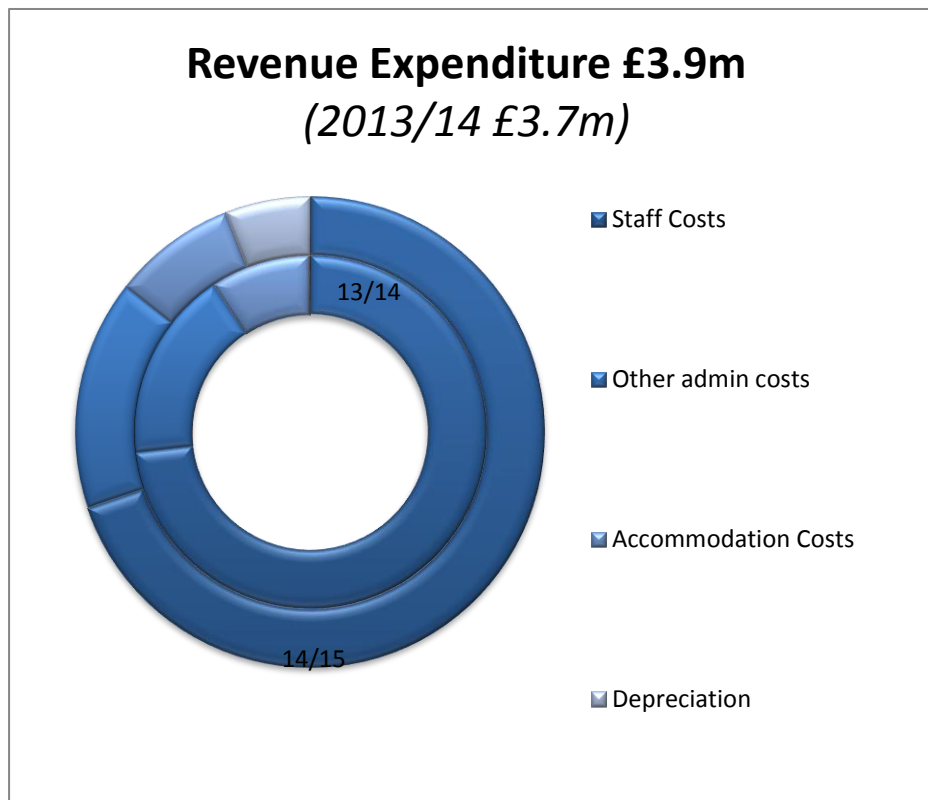
Key messages

 <p>Audit of financial statements</p>	<ul style="list-style-type: none">• Unqualified independent auditor's report on the 2014/15 financial statements.
 <p>Financial management and sustainability</p>	<ul style="list-style-type: none">• The Scottish Housing Regulator operated within its overall resource budget for 2014/15.• The financial position remains stable with an excess of total assets over liabilities. SHR has medium term financial plans in place, incorporating assumptions on funding levels and pay costs.
 <p>Governance and transparency</p>	<ul style="list-style-type: none">• Overall we found that the Scottish Housing Regulator had sound governance arrangements.• Board minutes and registers of interest for SHR board members are publicly available via the organisation's website.

Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of the Scottish Housing Regulator (SHR).
2. The management of SHR is responsible for:
 - preparing financial statements which give a true and fair view, in accordance with the relevant financial reporting framework
 - ensuring the regularity of transactions, by putting in place systems of internal control
 - maintaining proper accounting records
 - preparing and publishing with their financial statements an annual governance statement and a remuneration report.
3. Our responsibility, as the external auditor of SHR, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; that have been prepared by management with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.
5. A number of national reports have been issued by Audit Scotland during the course of the year. These reports are summarised at **appendix II** and include recommendations for improvements where appropriate.
6. **Appendix III** is an action plan setting out our recommendations to address 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 "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that SHR understands its risks and has arrangements in place to manage these risks. The committee should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

2014/15 financial statements



The financial statements show revenue expenditure has increased by £0.2m (5%) to £3.9m. This was largely due to depreciation, which increased from £4,000 in 2013/14 to £230,000 in 2014/15 due to the increase in assets comprising the Business Intelligence IT system, which were purchased last year and depreciated for the first time in 2014/15. Staff costs and other admin costs are in line with 2013/14 costs.

In addition to the revenue expenditure shown in the graph, SHR had capital expenditure of £0.502m (2013/14 £1.148m); the majority of spend in both years was on the Business Intelligence IT system.

Audit of the 2014/15 financial statements

Audit opinions

Financial Statements

- The financial statements of SHR for 2014/15 give a true and fair view of the state of the body's affairs and of its net expenditure for the year.
- We confirm that the financial statements have been properly prepared in accordance with the 2014/15 FReM and the requirements of the Public Finance and Accountability (Scotland) Act 2000.

Regularity

- In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

Other prescribed matters

- The remuneration report to be audited has been properly prepared in accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions.
- The information in the strategic report and directors' report is consistent with the financial statements.

Submission of financial statements for audit

9. The unaudited financial statements, including the remuneration report, strategic report, directors' report and governance statement, were received on 18 May 2015, in line with the agreed timetable.
10. The working papers were of a high standard and staff provided excellent support to the audit team which enabled us to complete our on-site fieldwork by the agreed target date.

Overview of the scope of the audit of the financial statements

11. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the SHR Audit and Risk Committee on 20 March 2015.
12. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2014/15 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.
13. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on

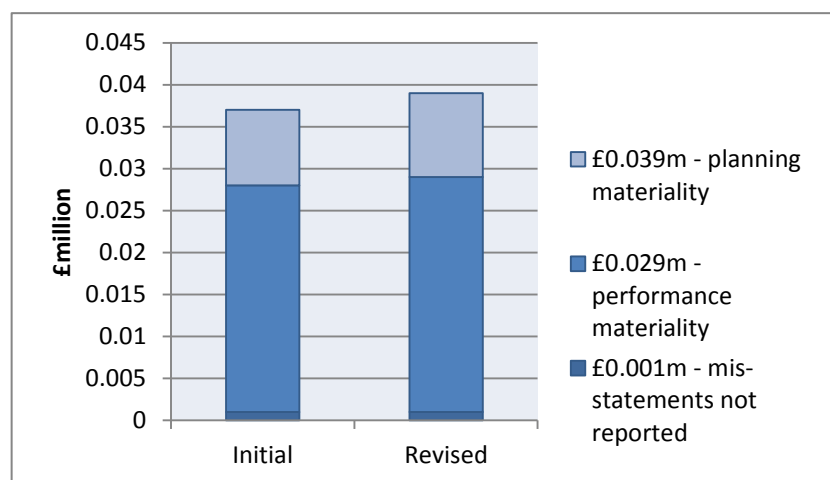
the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance in respect of these risks.

14. **Appendix I** set out the significant audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.
15. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

16. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other qualitative reasons (for example an item contrary to law).
17. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

18. We summarised our approach to materiality in our Annual Audit Plan. Based on the financial statements, we revised our planning materiality for 2014/15 to £39,000 from £37,000 (1% of gross expenditure). Performance materiality of £29,000 is determined to ensure that uncorrected and undetected audit differences do not exceed our planning materiality level. We report all misstatements greater than £1,000.



Evaluation of misstatements

19. All misstatements identified during the audit, which exceeded our misstatement threshold, have been amended in the financial statements.

Significant findings from the audit

20. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit:
- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and disclosures.
 - Significant difficulties encountered during the audit.
 - Significant matters arising from the audit that were discussed, or subject to correspondence with management.
 - Written representations requested by the auditor.
 - Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.
21. We had no significant findings.
22. A number of presentational and monetary adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements. There was no change to the expenditure total and no overall effect on the net asset position. A summary of these adjustments is contained in the following table.

Adjustments from the audit in accordance with ISA260

23. Audit testing identified £87,355 of capital accruals which had been included in the cashflow statement. SHR officers adjusted the draft accounts to exclude these items from the non current asset additions and movement in payables figures in the cashflow statement.
24. Non current assets additions shown in the draft accounts included £4,678 of IT equipment which was not capitalised due to the value being less than the capitalisation threshold as set out in the SHR's accounting policies shown at note 1 to the accounts. The full value of these items was charged to depreciation during 2014/15. SHR officers amended the accounts to include these items in IT costs rather than depreciation. Non current assets, accumulated depreciation and depreciation expense shown in the accounts were reduced by £4,678, while IT costs increased by £4,678.
25. SHR officers expanded the disclosure of outturn against budget included in the management commentary to give a fuller picture of SHR finances during 2014/15.

Future accounting and auditing developments

Revisions to the Financial Reporting Manual (FReM)

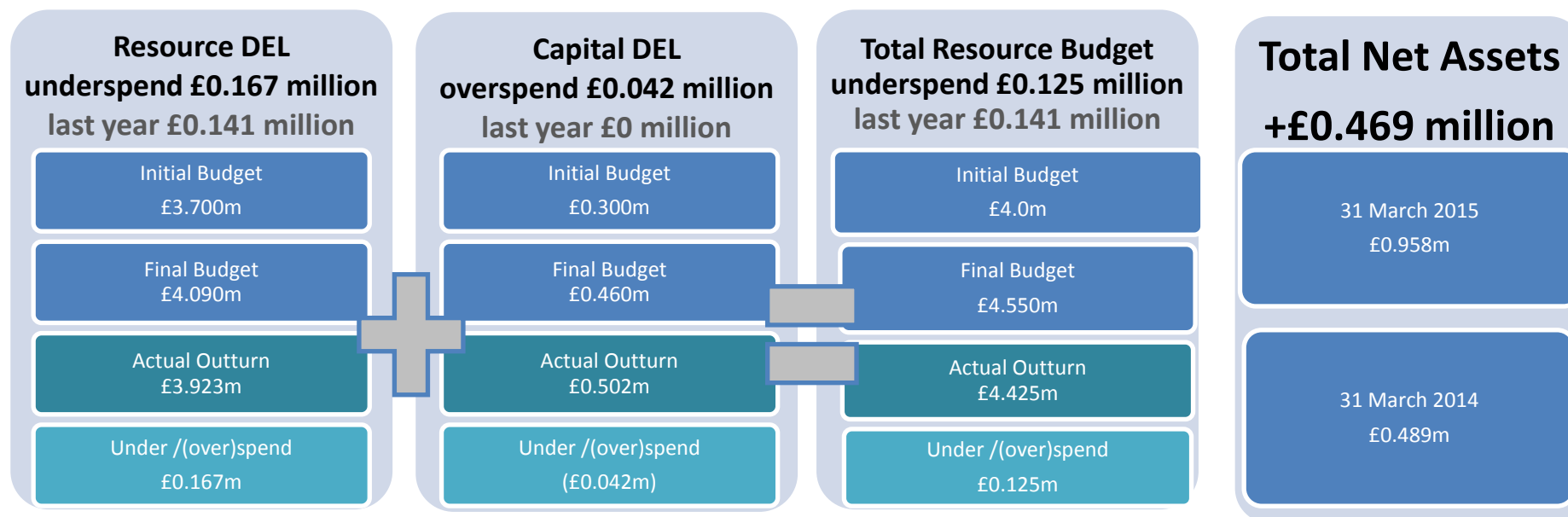
26. The financial statements are prepared in accordance with the Government financial reporting manual (FReM). Two significant revisions will apply from 2015/16:
 - Adoption of IFRS13 *Fair value measurement* for the first time – this also includes IAS 16 and IAS 38 adaptations.
 - Simplification and Streamlining Project – changes to the form and content of the annual report and accounts.

27. **International Financial Reporting Standards (IFRS) 13 Fair value measurement:** Sets out the requirements for assets to be valued at fair value and is applied in full by the FReM only to assets that are not held for their service potential (i.e. investment properties and assets held for sale). It also applies to operational assets which are surplus to requirements where there are no restrictions on disposal which would prevent access to the market.
28. IFRS 13 does not apply to operational assets which are in use delivering front line services or back office functions, and surplus assets with restrictions on their disposal. These will be valued in accordance with the adaptations to *IAS (International*

Accounting Standard) 16 property, plant and equipment. It is therefore unlikely that IFRS 13 will apply to SHR.

- 29. Restructuring of the annual report:** the 2015/16 FReM has been extensively re-written to require the annual report and accounts to include:
- A performance report which will give a fair, balanced and understandable analysis of performance and will include an overview section and a performance analysis section.
 - An accountability report incorporating the following three main sections:
 - corporate governance report consisting of a directors' report, a statement of the Accountable Officer's responsibilities and a governance statement
 - remuneration and staff report which will cover a number of prescribed disclosures including remuneration policy, payments to directors, staff numbers and sickness absence rates
 - parliamentary and accountability report which will include information on the regularity of expenditure and the independent auditor's report.
- **Refer Action Plan no. 1**

Financial management and sustainability



- 30. The main financial objective for SHR is to ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers. SHR operated within its overall resource budget for 2014/15 as detailed above.
- 31. The £0.042m overspend against the capital DEL budget shown above is due to the capitalisation of the costs of SHR staff working on the development of the Business Intelligence IT

system. The overspend was funded by SHR’s resource DEL underspend. SHR have kept Scottish Ministers informed of the level of capital spending in 2014/15.

2014/15 financial position

- 32. At 31 March 2015 SHR’s statement of financial position shows an increase in total net assets of £0.469 million which can be

attributed to additional assets comprising the Business Intelligence system.

33. The financial position of SHR remains stable with the body operating within its available funding (on an accounting and resource basis) and with an excess of total assets over liabilities.
34. The 2015/18 Corporate Plan was approved at the February board meeting and shows a balanced budget of £4.041 million for 2015/16. SHR are currently forecasting a full spend against the 2015/16 budget.

Financial management

35. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
 - sufficient status and resources are given to finance reporting to be able to deliver good financial management
 - standing financial instructions and standing orders are comprehensive, current and promoted within the body
 - reports monitoring performance against budgets are accurate, provide good variance analysis and provided regularly to budget holders
 - monitoring reports do not just contain financial data but are

linked to information about performance

- members provide a good level of challenge and question budget holders on significant variances.
36. We reviewed budget update reports to the executive management team and the Board. Based on our accumulated knowledge and our review of board papers we conclude that SHR has satisfactory budget monitoring arrangements in place.

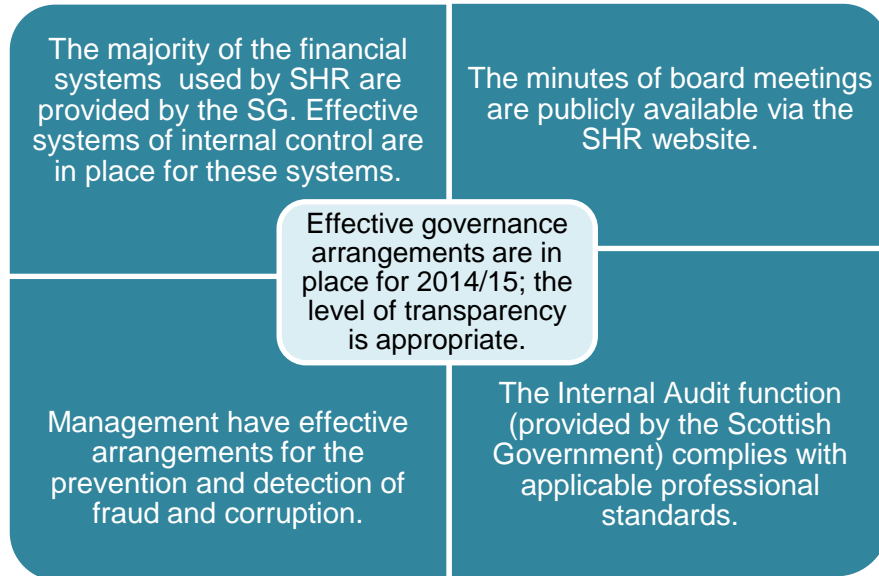
Financial Capacity baseline information

37. Audit Scotland's Performance and Best Value department is currently completing a piece of work to collect baseline information about finance departments and the control environment across the public sector. Audit feedback indicates that overall reductions in staff numbers in public bodies may be affecting the capacity of back-office functions, including finance and other related activities. The information will be used to identify a number of common and emerging issues and may be reported in sector specific overview reports. The information would also support the development of the future performance audit programme.
38. Our completion of this work in relation to SHR finance functions concluded we had no specific risks to note over financial

capacity. We note the following:

- Senior staff are involved in the finance process at SHR and have appropriate status and influence. We found that the level of detail in budget reports and updates to the Board is good. While there are no senior staff with a dedicated finance role, as may be expected in a small organisation, the Director of Strategy & Communications and Head of Planning & Performance have finance responsibility as a key part of their wider roles, alongside the Finance Officer. Financial management and reporting is accorded an appropriately high level of importance.
- There are no qualified accountants in Planning and Performance. SHR's approach of having Regulation Analysts, who are qualified accountants, prepare the accounts alongside the Finance Officer, has been effective in providing good quality accounts for audit, without additional cost to SHR. We have found the good quality of accounts and working papers to have been maintained over the past few years.
- Despite the uncertainty of funding after 2015-16, SHR has prepared medium term plans, using assumptions and scenario analysis. The financial plans produced by SHR for future years are appropriately detailed given the level of information on future funding and expenditure which is available.
- Audit Scotland's report *Scotland's Public Finance A follow-up report: progress in meeting the challenges* recommends that public bodies prepare priority based budgeting whereby budgets make connections between planned spending and intended outcomes. This is meant to help with decision making and accountability. SHR's budgets are split into expenditure headings by nature of spend, rather than linked to outcomes.
- SHR has one overall objective and has five planned actions. Management advise that these actions are inter-related and there is no direct spend associated with specific actions or outcomes. Staff are not employed to work towards single actions. With 70% of costs on staff costs splitting out costs to activities would be based on arbitrary allocations and should there be a significant reduction in budget from the Scottish Government, SHR would have to review how it carried out its work altogether, rather than stop doing one particular activity.
- Financial planning includes management and the Board. In September 2015 the Board met to assess potential future budget scenarios and what the impact would be in terms of the work of SHR, risks and choices to be made.

Governance and transparency



Corporate governance

39. SHR is led by a board of non-executive members. The board members have collective responsibility for the actions and decisions of the regulator and are accountable to the Scottish Parliament. The chair and members of the SHR board are appointed by Scottish ministers through the public

appointments process.

40. The Accountable Officer (Chief Executive) is responsible for the day to day operation of SHR and for leading the organisation's staff. The chief executive is held to account by the board and is personally answerable to the Scottish Parliament for the effective and efficient operation of SHR.
41. The board and chief executive are supported in their roles by the SHR Audit and Risk Committee (ARAC). The ARAC meet quarterly to consider relevant matters.
42. In addition, SHR has is a project board to oversee the delivery of the Business Intelligence IT project. This board will be in place until the completion of the project.
43. The SHR corporate plan covering the three year period from 2015 to 2018 was approved by the board in February 2015 and is available to the public via the SHR website.
44. The plan sets out SHR's organisational objectives, values, aims and priorities as well as the means by which SHR expect to achieve these objectives and the main risks in the social housing sector.
45. We concluded that the SHR has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

Transparency

46. We considered how SHR accounts and reports transparently on their resources.
47. The financial statements clearly include reconciliation between expenditure and the outturn against Scottish Government Resource budgets. The financial statements also identify and explain significant movements in budget during the year.
48. Audit Scotland's September 2010 report, *Role of Boards* recommended that public bodies should maximise the openness and accessibility of their board meetings and papers and ensure that board members are asked to declare any interests they have at all board meetings; where a conflict exists they do not participate in discussions and this is formally recorded.
49. The Scottish Government's *On Board* guidance, a guide for board members of public bodies was updated and reissued in April 2015. *On Board* states that boards should demonstrate high standards of corporate governance at all times including openness and transparency in its decision making. It recommends boards should consider:
- Holding an annual open meeting.
 - Holding board meetings in public unless there is a good reason not to.
 - Publishing summary reports and/or minutes of meetings
- Inviting evidence from members of the public in relation to matters of public concern.
 - Consulting stakeholders and users on a wide range of issues.
 - Making corporate plans and the annual report widely available.
50. SHR's website includes corporate plans, annual reports and minutes of all board meetings. The minutes record declarations of interest. Registers of interest for board members are also available from the website.
51. Stakeholder engagement is a key part of the SHR's work and internal audit reported positively on SHR's arrangements in their 2014/15 report. During 2015-16 SHR plan to publish an updated Consultation and Involvement Strategy.
52. With the reissue of *On Board*, we understand that SHR is planning to review the report's recommendations in light of its current policies and practices, recognising that some parts of the guide are not applicable to Non-Ministerial Departments (NMDs). SHR has already been in dialogue with the Scottish Government about *On Board*'s applicability and the future issue of guidance tailored more specifically for NMDs.

- Refer to action point 2

Internal control

53. SHR relies on systems owned and operated by the Scottish Government. These central systems, including the general ledger and the payroll, accounts payable and accounts receivable systems are subject to an annual review by Audit Scotland's Scottish Government external audit team.
54. The 2014/15 review found no material weaknesses in the accounting and internal control systems which could adversely affect the organisation's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Internal audit

55. Internal audit provides the Audit and Risk Committee and accountable officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.
56. Internal audit at SHR is provided by the Scottish Government Internal Audit Service, the operation of which was assessed by our Scottish Government external audit team. This

assessment concluded that the internal audit service operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

57. In June 2015 internal audit reported they had not completed all of their work however they anticipated completing it in July and providing overall substantial assurance on the internal control environment. While this would meet the timetable for signing the accounts, the Audit and Risk Assurance Committee expressed disappointment not to receive the report in June, which is when they consider the accounts. Internal audit committed to delivering next year's audit by June 2016.
58. The internal audit report was duly provided in July. For 2014/15, we placed reliance on the work of internal audit in terms of our wider code responsibilities.

SHR Framework Agreement

59. The SHR framework agreement, which sets out the relationship between and responsibilities of the board and accountable officer of SHR, the Scottish Parliament and the Scottish Government, was reviewed at the end of 2014/15.
60. The revised agreement allows the establishment of Memoranda of Understanding between SHR and the Scottish Government to cover SHR's use of Scottish Government systems and services, for example internal audit and IT

support.

61. This has addressed the issue we raised in previous years on the lack of formal agreements between SHR and the Scottish Government covering the parameters under which such services are provided.

Arrangements for the prevention and detection of fraud

62. We assessed the arrangements for the prevention and detection of fraud during the planning phase of our audit. This involved:
- reviewing the SHR fraud policy and response plan
 - reviewing arrangements for the communication of potential fraudulent activity to the SHR board.
63. We conclude that there are effective arrangements for the prevention and detection of fraud.

National Fraud Initiative in Scotland

64. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise led by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify circumstances (matches) that might suggest the existence of fraud or error.

65. SHR are involved in the NFI via their use of Scottish Government systems. We have been informed by SHR management that there were no matches relating to SHR during 2014/15.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

66. SHR has in place a range of activities designed to maintain standards of conduct including Codes of Conduct for officers and members. Also, there are established procedures for preventing and detecting corruption including annual reviews of Standing Financial Instructions and Standing Orders. New staff are advised of the Whistleblowing policy by their line managers.
67. Based on our review of the evidence we concluded that there are appropriate arrangements in place for the prevention and detection of corruption and we are not aware of any specific issues that we need to record in this report.

Best Value

68. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.

Arrangements for securing Best Value

69. In 2012 SHR agreed to carry out a series of seven best value reviews over the three-year period of the 2012-2015. Corporate Plan Reviews of Equalities and Sustainability were concluded and reported to the ARAC in June 14 and December 14 respectively.
70. As a result of these reviews, the SHR ARAC considered:
- The need for equalities to be integrated in SHR's work;
 - SHR's duties to Gypsies/ Travellers;
 - Partnership working;
 - Equal treatment of staff and Scottish Government policies;
 - Board diversity;
- and
- if SHR can influence sustainability more, given the limitations imposed through their status as a minor occupier of a Scottish Government leased building;
 - the implications of Energy Efficiency Standard for Social Housing and Scottish Housing Quality Standard on

sustainability.

71. Neither review identified significant weaknesses in SHR arrangements in these areas. One review of the seven remains to be completed in 2015/16.
72. These reviews have been developed locally by SHR with reference to the best value toolkits produced by Audit Scotland. We consider that this is a proportionate and appropriate approach.

National performance audit reports

73. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2014/15, a number of reports were issued which are of direct interest. These are outlined in **appendix II**.
74. SHR has processes in place to ensure that all relevant national performance reports are considered by the Audit and Risk Assurance Committee. In addition, in October 2015 the committee held a workshop to discuss two Audit Scotland reports *Managing ICT Contracts* (see below) and *Scotland's Public Finances – A follow-up audit: progress in meeting the challenges*. This provided the opportunity to consider lessons learned but also to discuss the level of assurance that SHR was already delivering some of the recommendations on medium term financial planning.

75. Managing ICT contracts – follow up.

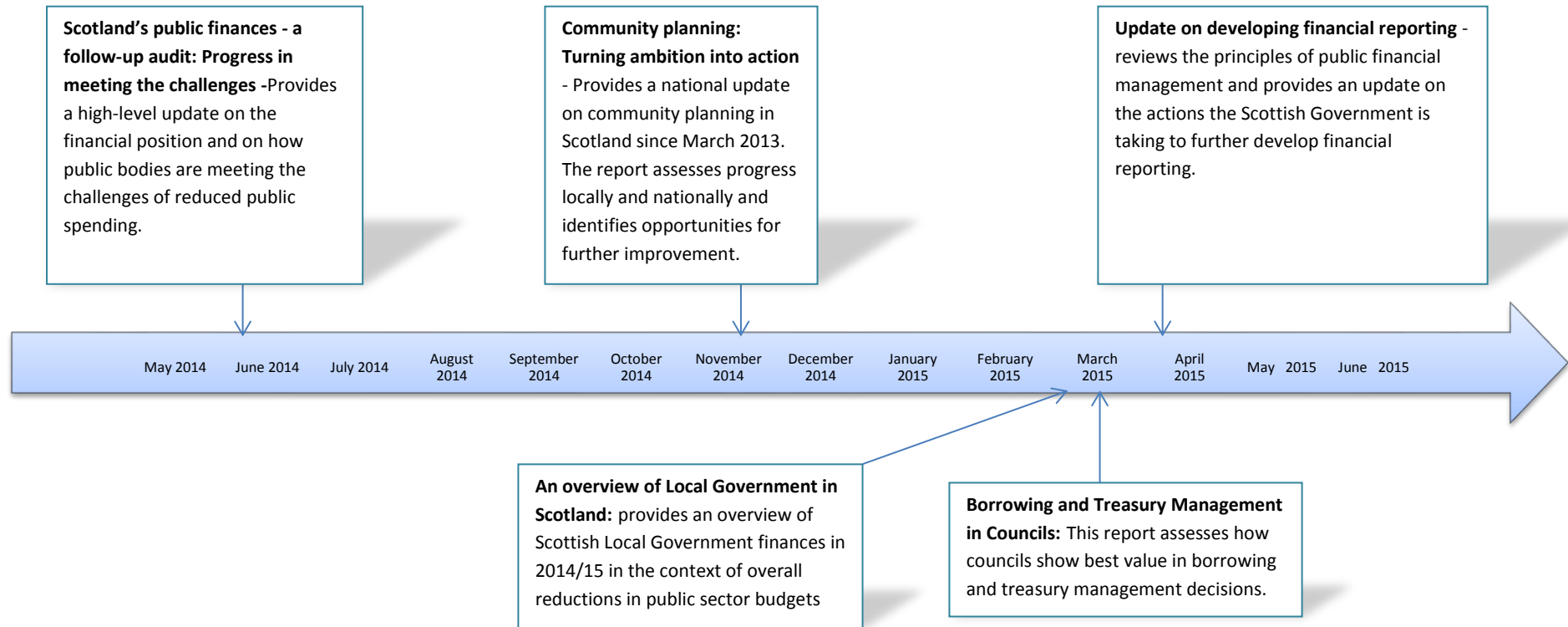
This report was published in June 2015 by Audit Scotland and reviews the management of ICT projects by Scottish public sector organisations following the initial report on *Managing ICT Contracts* published in August 2012. The SHR Business Intelligence project was one of the ICT projects reviewed as part of the report and the project was commended for successfully using a mixture of fixed price and Agile models.

Appendix I – Significant audit risks

The table below sets out the financial statement audit risks, how we addressed each risk and our judgement in arriving at our opinion on the financial statements.

Audit risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
<p>Management override of controls</p> <p>(Statement of Comprehensive Net Expenditure, Statement of Accounting Policies (20))</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>Detailed testing of journal entries.</p> <p>Review of accounting estimates for bias.</p> <p>Evaluating significant transactions that are outside the normal course of business.</p> <p>Focused testing of accruals and prepayments.</p>	<p>Testing of journal entries and of accruals did not identify any errors or anomalies. There was no evidence of management bias in the accounting estimates included in the 14/15 accounts.</p>
<p>Identification of Capital Expenditure</p> <p>(Statement of Comprehensive Net Expenditure, Statement of Financial Position)</p> <p>In 2014/15, there will be a mixture of capital and revenue expenditure related to the business intelligence programme.</p> <p>There is a risk that costs are incorrectly classified leading to operating and capital expenditure being misstated.</p>	<p>Detailed testing of invoices to assess classification.</p> <p>Review of capitalisation journal.</p> <p>Review of estimate of capitalised staff costs.</p>	<p>No evidence of expenditure being misclassified between capital and revenue was identified through completion of the procedures noted.</p>

Appendix II – Summary of national reports 2014/15



Appendix III – Action plan

Para	Issue/Risk/Recommendation	Management action/Response	Responsible officer	Target date
Financial audit Issues				
29	<p>Restructuring of the Annual Report and Accounts</p> <p>The 2015/16 FReM has been extensively re-written to require the annual report and accounts to include:</p> <ul style="list-style-type: none"> • a performance report • an accountability report incorporating <ul style="list-style-type: none"> - a corporate governance report - a remuneration and staff report - a parliamentary and accountability report <p>Risk changes not fully implemented</p> <p>There is a risk that the required changes will not be fully incorporated in the 2015/16 annual report and accounts.</p> <p>Recommendation</p> <p>Staff meet auditors to discuss changes to the annual accounts required by the 2015/16 FReM.</p>	Staff will meet auditors to discuss changes to the annual accounts required by the 2015/16 FReM.	Head of Planning and Performance	December 2015

Para	Issue/Risk/Recommendation	Management action/Response	Responsible officer	Target date
Wider audit issues				
52	<p>Board meetings</p> <p>Scottish Government has re-issued its guidance <i>On- Board</i> but SHR has not yet had the opportunity to review the updated version.</p> <p>Risk</p> <p>SHR risk not following current Scottish Government guidelines and current best practice reflected therein.</p> <p>Recommendation</p> <p>We recommend SHR review the report's recommendations in light of their current policies and practices.</p>	A review of <i>On Board</i> will be carried out against SHR's policies and practices.	Director of Strategy and Communications	30 November 2015