AUDIT SCOTLAND

Registers of Scotland

2015/16 Annual audit report to Members and the Auditor General for Scotland

August 2016

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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively (www.audit-scotland.gov.uk/about/).

Mark Taylor, Assistant Director, Audit Scotland is the appointed external auditor of Registers of Scotland for the period 2011/12 to 2015/16.

This report has been prepared for the use of Registers of Scotland and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in it may be used by the Auditor General in support of her wider responsibilities, including reporting to the Scottish Parliament.

Contents

Key messages

Audit of the 2015/16 financial statements	• Unqualified independent auditor's report on the 2015/16 financial statements. • Compared to prior years the number and size of audit adjustments has increased, indicating a need for improved review of the draft accounts by management. The net impact of all audit adjustments was to decrease the retained surplus by £0.035 million.
Financial management and sustainability	• Retained surplus for the year was £7.5 million, increasing aggregate retained surplus to £87.1 million. • Income, expenditure and profits all increased compared to 2014/15 and there was a significant increase (17 per cent) in staff costs. • Total expenditure was less than anticipated as some costs relating to the Business Transformation Programme anticipated in 2015/16 were not incurred until 2016/17. • Major changes affecting how the organisation delivers its services such as the Business Transformation Programme and Land Register Completion increases the importance of RoS undertaking effective longer-term financial planning.
Governance, accountability and Best Value	• Overall we found that RoS had sound governance arrangements in place during 2015/16. • Systems of internal control operated effectively during 2015/16. • The assessment and approval of three exit settlements paid during the year was not sufficiently documented.
Outlook	• The Business Transformation Programme is established and delivering initial benefits. The scope of the programme has expanded to cover the development of New Registers and Scottish Land Information System. • Full benefit realisation will be dependent on significant workforce changes. RoS needs to produce an organisational-wide workforce plan which maps its current workforce against the organisation’s resourcing requirements over the short, medium and long-term. • Programme management arrangements have been restructured for Land Register Completion. There remains uncertainty regarding the cost of completion and the organisation’s ability to meet the targets set. • Details of RoS’ role in relation to the new Land Reform (Scotland) Act, including any financial implications, have yet to be determined.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Registers of Scotland (RoS).

Our annual audit report

2. Our report is divided into the following sections to reflect our public sector audit model. These are:
   - Audit of the 2015/16 financial statements
   - Financial management and sustainability
   - Governance and transparency
   - Value for money

3. Appendix I highlights significant audit risks and our corresponding audit work. In addition, a number of reports, both local and national, were issued by Audit Scotland during the course of the year. These reports, summarised at appendix II and appendix III, include recommendations for improvements. Appendix IV is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit.

4. The management of RoS is responsible for:
   - preparing financial statements which give a true and fair view
   - ensuring the regularity of transactions, by putting in place systems of internal control
   - maintaining proper accounting records
   - ensuring that the financial position is soundly based.

5. RoS' 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 although it is important that RoS understands its risks and has arrangements in place to manage these. The organisation should ensure that it is satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.

6. Our report includes 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.

Our appointment as external auditors

7. Our responsibility, as the external auditor, 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.

8. 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 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

which give a true and fair view. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

9. This is the final year of the current five-year audit appointment. From 2016/17, Audit Scotland will continue as external auditors of RoS although the appointed auditor and audit team will change. In accordance with agreed protocols and International Standards on Auditing we will liaise closely with the new audit team during this transition.

Audit of the 2015/16 financial statements

Financial statements	• The financial statements of Registers of Scotland for 2015/16 give a true and fair view of the state of the body's affairs and of its retained surplus for the year. • We confirm that the financial statements have been properly prepared in accordance with the 2015/16 Government Financial Reporting Manual (FReM) and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions.
Regularity of income and expenditure	• In our opinion, in all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with any applicable legislation and guidance.
Other information	• The part of the Remuneration Report to be audited has been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers. • The information given in the Performance Report is consistent with the financial statements. • We report any material errors or omissions, any material inconsistencies with the financial statements or any otherwise misleading content. We have nothing to report in respect of the other information published as part of the annual report and accounts.

Submission of financial statements for audit

10. We received the unaudited financial statements on 27 May 2016, in accordance with the agreed timetable. The working papers were of a good standard and staff provided support to the audit team which enabled us to deliver the audit by the deadline.

11. The financial statements are prepared in accordance with the Government Financial Reporting Manual (FReM). This year, there were considerable changes to the annual report to include a performance report (which has replaced the management commentary) and an accountability report which includes the governance statement and the renamed remuneration and staff report. These changes were reflected in RoS' annual report and accounts.

Overview of the scope of the audit of the financial statements

12. 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 Audit and Risk committee on 16 February 2016.

13. 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 any non-audit related services. The 2015/16 agreed fee for the audit was £54,570. In response to a request from RoS we undertook additional work to provide a statement of assurance in relation to the costs incurred by RoS to process the Land and Buildings Transaction Tax. This increased our fee by £1,100 to £55,670.

14. The concept of audit risk is central to our audit approach. We focus on the areas that are most at risk of causing material misstatement in the financial statements. In addition, we consider what risks are present in respect of our wider responsibility, as public sector auditors, under Audit Scotland's Code of Audit Practice.

15. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. Appendix I sets out the audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

16. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the statements are free from material misstatement, whether caused by fraud or error.

Materiality

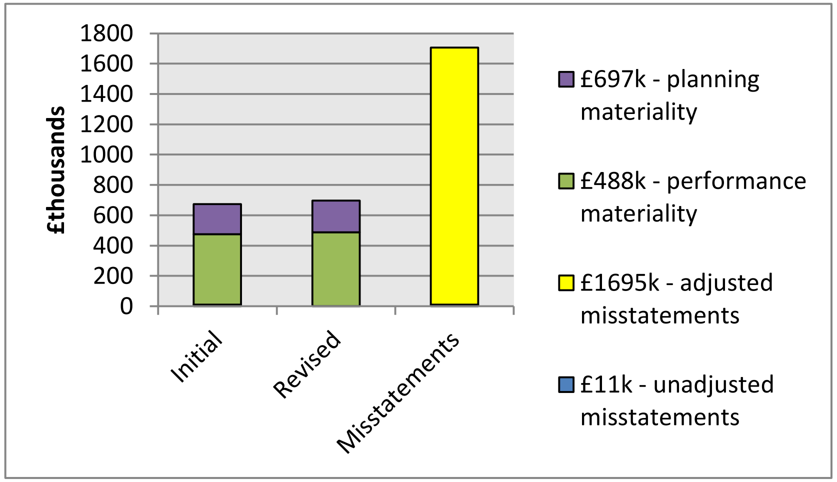
17. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).

18. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit procedures. We assess the materiality of uncorrected misstatements, both individually and collectively.

19. We summarised our approach to materiality in our Annual Audit Plan. We revised our planning materiality for 2015/16 on receipt of the unaudited accounts to £697,000 (one per cent of operating income of £69.7 million).

20. We also set a lower level, known as performance materiality, when defining our audit procedures. This is determined to ensure that uncorrected and undetected audit differences do not exceed our materiality level. Performance materiality was set at £488,000. We report all misstatements greater than £5,000.

Exhibit 1: Overall materiality and misstatements



Source: 2015/16 Annual Audit Plan

Evaluation of misstatements

21. We identified ten misstatements in the unaudited financial statements, with a gross value of £1.695 million. Nine of these were adjusted by management in the audited accounts. This had the net effect of reducing the retained surplus by £35,000 and decreasing net assets by £35,000.

22. It is our responsibility to request that all errors be corrected, although the final decision on this matter rests with those charged with governance taking into account advice from officers. The sole unadjusted misstatement, if adjusted, would have increased the retained surplus and net assets by £11,000. Management accepted this error but decided not to adjust. We accept this decision as the amount involved is below our materiality threshold. Table 1, on page 10, provides details of the misstatements identified.

23. The total value of adjustments exceeded our overall performance materiality level of £488,000. Further audit procedures were performed to provide assurance that the errors identified were isolated in nature and not pervasive to either the account area or the financial statements as a whole.

Significant findings from the audit

24. International Standard on Auditing 260 (ISA 260) requires us to communicate to you significant findings from the audit as detailed below:

- 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.

25. The following table details those issues or audit judgements that, in our view, require to be communicated to you, as those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260
Valuation of Work In Progress inventory and provision balances These balances are calculated using a series of spreadsheets and stock and cost information drawn from the Land Registration system and the financial ledger. During our review we identified two errors, one relating to the use of an incorrect year-end stock figure and the other due to an error in the spread-sheet where a cost adjustment was not included in the final calculation. **Resolution:** RoS have recalculated the balances and processed the necessary adjustments to the financial ledger. The gross adjustments of £119,000 and £303,000 increased the retained surplus by £377,000. We are content with these adjustments. ***Appendix IV – Action Plan No. 1***

Significant findings from the audit in accordance with ISA260
Payments processed incorrectly through the financial ledger Following a review of the trade payables balance, we identified two payments that had not been processed correctly through the purchase ledger control account prior to the year end. This had the effect of understating the trade payables balance in the draft accounts. **Resolution**: Following an investigation, RoS processed two adjustments to the financial ledger. The first increased both the Trade Payables and Trade Receivables balances by £358,000, the second reduced the Trade Payables balance by £342,000. We are content with the adjustments to the accounts. ***Appendix IV – Action Plan No. 2***
Withdrawn registration fees Included within the trade payables balance is approximately £857,000 of fees received relating to withdrawn registrations. RoS has a policy to refund fees received for registrations which are subsequently withdrawn, after 60 days, unless they are resubmitted. Around £438,000 relates to registrations withdrawn which are older than 60 days with some relating back to before 2014. We identified a risk that RoS are holding fees which it is not entitled to, or failing to recognise revenue for submitted registrations. The respective amounts are uncertain. **Resolution:** Having considered the matter we are satisfied that the maximum amount of potentially unrecognised revenue is below our materiality threshold. RoS have outlined steps to address this issue in 2016/17. ***Appendix IV – Action Plan No. 3***
Recording of income received for Lomond House sub-lease From a review of rent expenses in 2015/16, we identified an issue where income received from Skills Development Scotland relating to the sub-lease of Lomond House in Glasgow was netted off against expenditure rather than recorded as income. This had an effect of understating both income and expenditure. **Resolution**: RoS agreed to process an adjustment to the accounts. This had the effect of increasing both expenditure and income by £161,000. We are content with the adjustment to the accounts.

Significant findings from the audit in accordance with ISA260

Provision for VAT liability

In March 2016, RoS commissioned a VAT review from an external contractor to examine its processes and assess compliance with legislation and HMRC VAT guidance. The review challenged a number of VAT treatment decisions, identifying areas where RoS may have both over or underpaid VAT to HMRC.

Resolution: RoS accepted some instances where their treatment may have led to an underpayment of VAT. As a result, they decided to create a provision for £161,000. They will also pursue action to recover potential overpayments identified but in line with accounting standards, this cannot be recognised as a receivables asset at this stage. The adjustment had the effect of decreasing the retained surplus by £161,000 and we have agreed that this treatment is appropriate and in compliance with relevant accounting standards.

Appendix IV – Action Plan No. 4

Provision for Hanover House dilapidations

In December 2015, the RoS Board decided not to renew the lease on their main Glasgow office at Hanover House. At the end of the lease, RoS will be liable for any refurbishment costs necessary to return the building to its original condition. A professional services company has been commissioned to provide an estimate of costs. As the decision not to renew was prior to the financial year end, we considered that RoS should recognise a liability for dilapidations in their accounts.

Resolution: As the report is due before the accounts are signed, RoS have included a provision of £200,000 now, based on an estimate of the costs provided by their own estates management team. We are content with this approach, which has decreased the retained surplus by £200,000.

Significant findings from the audit in accordance with ISA260

Provision for significant indemnity claim

In July 2016, the Scottish Land Tribunal issued a ruling on an indemnity claim case between the Keeper and a third party. The ruling found against the Keeper and RoS now have a liability to pay compensation and legal costs of approximately £1 million.

Resolution: The indemnity case had not previously been provided for and following the outcome, RoS increased the overall indemnity provision by £1 million. As the error leading to the claim in question occurred prior to 31 March 2016, we are content that a provision should be included in the 2015/16 accounts.

Contingent Liability for pension costs relating to the transfer of former British Telecom staff

Following the termination of their contract with BT for the provision of IT services, some staff were transferred back to RoS under TUPE legislation. Under these arrangements, staff are entitled to transfer their pensions from the BT pension scheme into the Principal Civil Service Pension Scheme (PCSPS). Actuarial calculations on the value of each transfer are required and RoS are likely to be liable for a proportion of any shortfall.

Resolution: Discussions with the Government Actuarial Department (GAD), BT and the BT Pension Scheme are still on-going and at the moment no reliable estimates are available. RoS have disclosed this matter as a contingent liability in their accounts and we have accepted this treatment.

Evidence of approval and cost evaluation for Exit Packages

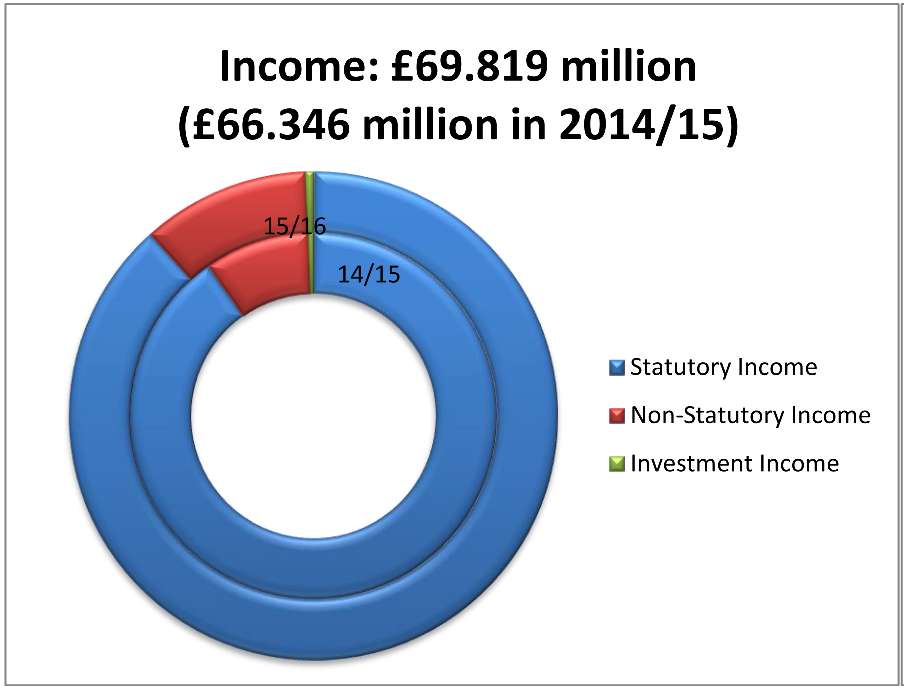
Where staff members apply for voluntary severance, a business case to assess the costs and benefits should be established to ensure decisions represent value for money and align with the organisation’s future workforce plans. Three RoS employees, including the former Director of Finance, left during 2015/16 and received lump sum payments calculated under Voluntary Exit Scheme rules. The assessment, decision and authorisation of exit package payments to the three employees was not sufficiently documented.

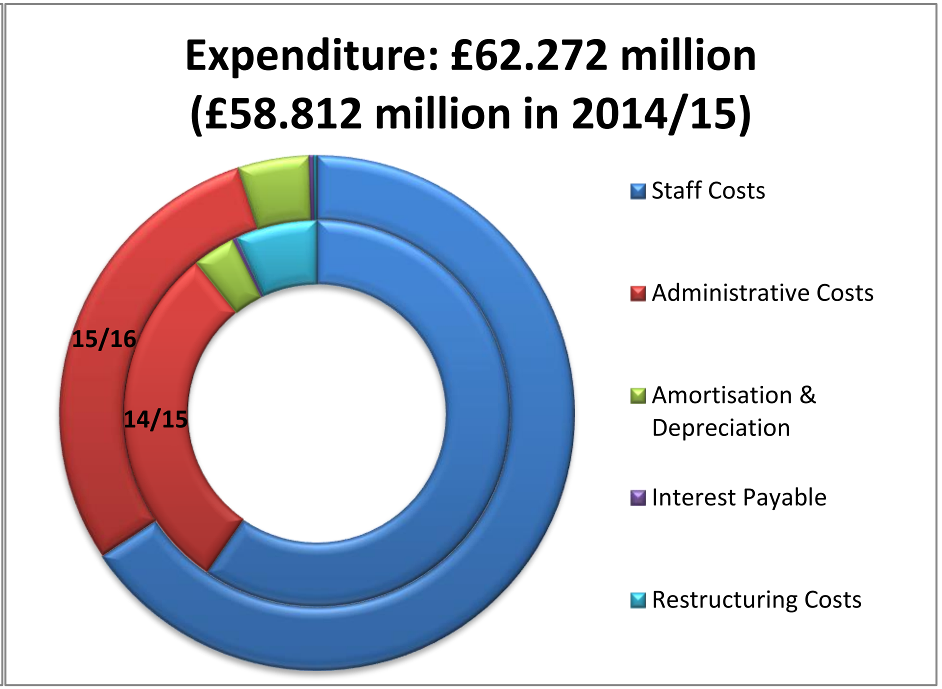
Resolution: We are content that settlements were in line with the parameters of the Voluntary Exit Scheme. In the absence of written documentation, only management assurances are available that the cases were assessed and authorised by senior management.

Appendix IV – Action Plan No. 5

Significant findings from the audit in accordance with ISA260
Accounting treatment of training costs As part of our audit work testing fixed asset additions, we identified two assets with values that included costs relating to staff training. These costs should not be treated as capital expenditure under IAS 16. **Resolution:** RoS accepted that this was an error and have processed an adjustment reducing the fixed asset balance and increasing expenditure by £27,000. We are content with this adjustment, which has decreased the retained surplus.
Accounting treatment of a software license We identified a three-year software license which had originally been accounted for as pre-paid revenue expenditure. RoS had subsequently reprocessed the transaction as a fixed asset but did not cancel the original prepayment. **Resolution:** RoS accepted that this was an error, and have processed an adjustment reducing the prepayment balance and increasing expenditure by £24,000. We are content with this adjustment, which has decreased the retained surplus.
Accounting treatment of catering equipment We identified a purchase of catering equipment (£11,000) that had been incorrectly treated as revenue expenditure. As the cost was above the capitalisation threshold of £5,000, the machine should be recognised as a capital asset. **Resolution:** RoS have accepted that the treatment was incorrect but have taken a decision not to adjust the accounts. As auditors we have accepted this matter as an unadjusted error and as the amount is below our materiality threshold it has had no impact on our audit opinion.

Financial management and sustainability





- Operating income for 2015/16 increased by £3.5 million (five per cent). Non-statutory income increased by 26 per cent due to an increase in demand for services following the implementation of the Land Registration 2012 Act in December 2014. Statutory income, which covers fees for amending the registers, rose by three per cent following an overall increase in property transactions in 2015/16.
- Overall expenditure increased by £3.5m (six per cent). Within this, there was a significant increase in staff costs (17 per cent) to meet increased demand and the cost of resourcing on-going major projects, particularly digital skills required by the Business Transformation Programme.
- The retained surplus of £7.5 million is marginally higher than 2014/15. This increased RoS' retained profits to £87.1 million.

Financial management

26. RoS is a non-ministerial department operating as a trading fund. It provides statutory and non-statutory services on a fee-charging basis and uses the income to fund its expenditure. RoS makes no claim on the Scottish Consolidated Fund.

27. Statutory fees and financial objectives are set by Scottish Ministers with a view to ensuring income is sufficient to meet expenditure. This is done across a multi-year period to ensure funding is available for investment in addition to day-to-day running costs.

2015/16 financial position

28. The Statement of Financial Position as at 31 March 2016 shows net assets of £90.5 million. This increased as a result of the £7.5 million retained surplus for 2015/16. RoS' asset base is predominantly made up of cash, most of which is held on short-term deposit with the National Loans Fund (NLF).

29. Surpluses are retained in order to fund future expenditure relating to major improvement projects. Both the Business Transformation Programme (formerly the Digital Transformation Programme) and Land Register Completion require significant investment. Surpluses must also be retained to fund running costs in the event of a significant property market downturn.

30. The retained surplus for the year was double the original forecast of £4.3 million in their 2015-2018 Corporate Plan. Both income and expenditure were lower than anticipated, with some expenditure relating to the Business Transformation Programme postponed until 2016/17.

31. An increase in property transactions for March 2016 and challenges in processing Transfers of Part registrations under the Land Registration Act 2012 has led to an increase in partially completed registrations at the year end. Increasing levels of arrears reduces both revenue and profit for the year, increases the pre-payment credit liability and has an impact on RoS' ability to meet its service standards.

Financial management arrangements

32. 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:

- the Director of Finance has sufficient status 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 and provided regularly to budget holders
- monitoring reports do not just contain financial data but are linked to information about performance
- Audit and Risk Committee members provide a good level of challenge and question significant variances.

33. Based on our accumulated knowledge, our review of Board and Executive Management Team meeting papers, and through our attendance at the Audit and Risk Committee we conclude that RoS has satisfactory financial management arrangements in place.

34. The Director of Finance left the organisation on the 31 March 2016. The majority of his duties are now carried out by the Head of Financial Strategy who was appointed on an interim basis from 6 June 2016.

Financial sustainability

35. RoS' current financial position is relatively healthy. There are a number of uncertainties and risks to financial sustainability in the medium and long term that will need to be managed

36. RoS' corporate plan covers a rolling three-year period and includes a high-level financial forecast, estimating income, expenditure and the resulting surpluses. Their 2016-2019 Corporate Plan was approved in March 2016. It forecasts significant increases in both income and expenditure and suggests that the organisation will continue to record small surpluses.

37. The Plan is based on income from property registers growing by over 50 per cent on 2015/16 levels, caused by an increase in the number of properties being added to the Land Register as a result of the Land Register Completion programme. Increased levels of expenditure are expected as a result of the increase in activity, with any investment in digitisation being offset by efficiency gains and lower processing costs.

38. Failure to realise benefits from the Business Transformation Programme and any requirement to process high volumes of Land Register Completion transactions without corresponding fee income, will result in increasing financial challenges for RoS. In addition, RoS will continue to be exposed to risks from any downturn in the property market. Together, these risks make it essential that RoS undertakes good medium to long-term financial planning that involves careful management of their existing reserves.

39. We have previously recommended RoS extends their financial planning horizons beyond the current three-year framework – with a view to covering the period through to their Land Register Completion deadline in 2024. RoS have made commitments to do this, and we will continue to monitor their progress in developing a long-term financial strategy.

Outlook

40. The next few years will see significant changes to how RoS manages and delivers its services. Fluctuations in demand arising from changes in legislation combined with plans to digitise services, provides a number of challenges and opportunities to the organisation that will require both careful planning and management.

Business Transformation Programme

41. RoS launched their Digital Transformation Programme in January 2015. The initial focus was on developing information technology improvements designed to:

- increase digital submissions of registrations by solicitors
- increase the level of automation in the registration process
- update the underlying IT infrastructure (software and hardware) in order to increase the resilience, security and adaptability of the registers.

42. Following a recommendation from external reviewers the programme was renamed as the Business Transformation Programme in March 2016 to recognise the level of change and impact across the whole organisation. The programme has broadened in scope and now covers projects in organisational development, the management of new registers and the creation of the Scottish Land Information System (SCOTLIS).

43. The budget for the programme is £24 million. During 2015/16, £4.6 million was spent against a forecast of £9.6 million. This underspend reflects changes to the timing of expenditure and not a reduction in overall anticipated costs. Current expenditure forecasts for 2016/17 are £14.3 million.

44. RoS continued to report inadequate disaster recovery provision as a key risk. The age and reliability of many elements of the IT infrastructure are the main reason for this concern. An early project within the Business Transformation Programme is the development of a new private cloud infrastructure in their primary data centre, supported by business continuity infrastructure hosted in a second data centre. This project is at an advanced stage with the majority of RoS' legacy systems now fully migrated to the new environment. Once all legacy systems are fully migrated to the new infrastructure, the risk of service interruption in the event of a disaster should be significantly reduced.

45. We previously reported on RoS' dependence on senior IT staff appointed using temporary contracts. Progress has been made to reduce this dependence with a number of key IT management roles now filled on a permanent basis, while other contracts have been extended.

46. Historically RoS has been dependent upon contracts with external suppliers to provide specialist support for key legacy operating systems operating. The migration activities required to allow these systems to migrate to the new private cloud means that they now operate in a current, more readily supported environment. Removing this dependence has facilitated the termination of these contracts with a number of staff transferring employment to RoS, providing increased capacity and capability to the IT department at a time of significant development.

47. It is anticipated that during the first two years of the Business Transformation Programme it will be necessary to further supplement both capacity and capability to ensure that system development keeps pace with the programme. The requirement to appoint a Strategic Integration Partner was included in the BTP business case, and a contract was awarded in July 2015. To help ensure that there is oversight of the work delivered by the new partner, a process of defining and documenting each deliverable was introduced with progress monitored at regular meetings.

48. The Business Transformation Programme is central to how the organisation will deliver its services in the future. The size and scale of the programme means it has significant financial, reputational and service delivery risks. It is therefore crucial that effective project management arrangements remain in place throughout the course of the programme to ensure it is successfully delivered on time, within budget and delivers the benefits expected.

Land Register Completion

49. In 2014 Scottish Ministers announced targets for Land Register Completion (LRC), with all public sector land to be registered by 2019 and all remaining tracts by 2024. Throughout 2015, RoS were managing a LRC project to establish the various methods needed to complete the register.

50. These methods include:
    - encouraging voluntary registration including offering a discounted fee
    - using the Keeper-induced registration method established by the LRA 2012 Act.
    - increasing the number of “trigger events” requiring a property to move on to the Land Register, for example closing the Sasines register for standard securities.

51. As at April 2016, 60 per cent of titles were included on the Land Register covering 28 per cent of land mass. There has been steady but limited progress on completion since the target was announced, however, it remains too early to measure the impact of the programme. As the date for completion gets nearer, the risk of missing the target increases, particularly as the targets rely on significant support and resources from each local authority in Scotland.

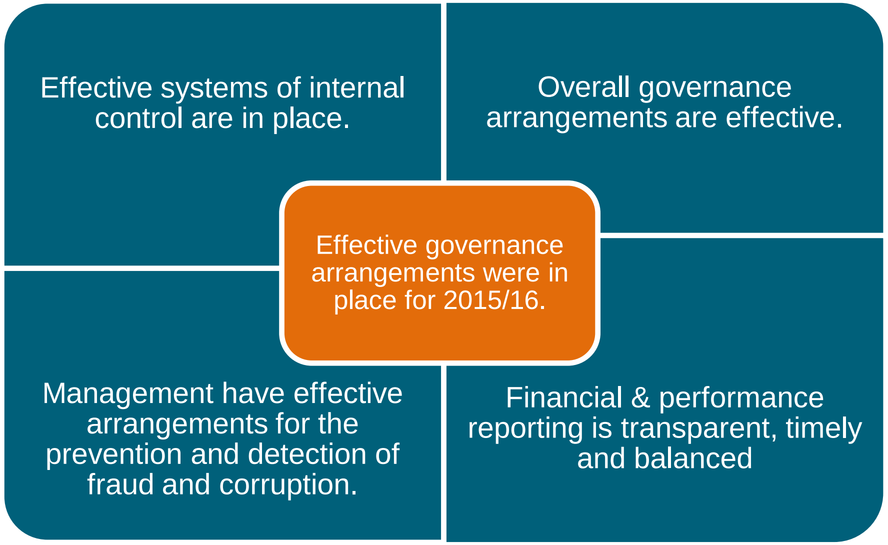
52. The estimated net cost in the initial business case for the project was £70 million covering the period through to 2024. This estimate was based on a number of assumptions relating to both the income from fees charged for first registrations and expenditure on the internal processing of the registrations. There is a significant dependency on the Business Transformation Programme delivering the efficiency savings necessary to ensure the affordability of the project.

Land Reform

53. The Land Reform (Scotland) Act 2016 received Royal Assent in April 2016. The Act requires the Keeper to maintain a new Register of Controlling Interests allowing the public to access an increased level of information about the owners of all land in Scotland.

54. Details of RoS’ role in managing the register will be established by regulations which will be considered by Parliament later in 2016 following public consultation. Although the financial memorandum accompanying the Bill did not forecast any significant cost implications for RoS, there is a risk that the creation and management of the register may draw on RoS’ financial and staffing resources placing additional pressures on their ability to deliver the Business Transformation Programme and achieve targets for Land Registry Completion.

Governance and transparency



Corporate governance

55. The Accountable Officer is responsible for establishing arrangements for ensuring the proper conduct of the affairs of RoS and for monitoring the adequacy of these arrangements.

56. As a statutory officer holder, the Keeper (Chief Executive) is prevented from assuming the role of Accountable Officer. This is held by the Operations Director. The RoS Board acts in an advisory capacity to both the Keeper and the Accountable Officer, and is supported in its role by the Executive Management Team (EMT) and the Audit and Committee (AC)

57. As at 31 March 2016, the Board consisted of six executive and four non-executive directors. Following the Director of Finance's departure, Board membership is set to reduce to nine in 2016/17. Three of the four non-executives departed the organisation during the year including the chair of the AC. Three new non-executive members and one additional independent AC member were recruited with handover arrangements in place whereby both incoming and outgoing Board members attended the December 2015 meeting.

58. RoS have established governance arrangements covering the programme and project management of both the Business Transformation Programme (BTP) and Land Register Completion (LRC). The BTP was subject to two external Gateway Reviews, the most recent in January 2016, and an internal audit report was issued in February 2016. Recommendations from all reviews are in the process of being implemented.

59. A Gateway Review on the LRC was undertaken in September 2015. It outlined a number of recommendations including a restructuring of the management arrangements, so that the LRC is now organised as a programme with constituent projects under it. An Internal Audit review of LRC pilot projects was postponed until 2016/17 as the projects had not reached an appropriately advanced stage.

60. RoS have undertaken several public consultations on LRC, the most recent, on Keeper-Induced Registration (KIR), was analysed and reported to Ministers in February 2016.

61. We conclude that RoS has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making. With significant changes underway to how RoS operates, it will be important for the organisation to keep its governance arrangements under review to ensure they remain fit for purpose.

Transparency

62. The Scottish Government's On Board guidance 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 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.

63. Within RoS all Board and committee meetings are held in private. Board minutes, corporate plans and annual reports are available on the RoS website, but minutes from 2016 meetings are not yet available.

64. Overall we conclude that RoS are as open and transparent as commercial considerations allow. However, they should keep their openness and transparency in decision making under review.

Internal control

65. No material weaknesses in the accounting and internal control systems were identified during the 2015/16 audit 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. Our work on internal controls was reported to the Audit and Risk Committee on 13 April 2016.

66. Our work on the financial statements did identify two incidents where payment procedures had not been followed. In both incidents alternative authorisation controls were in operation but they did not prevent non-material errors appearing in the financial statements. We have included a recommendation in Appendix IV that RoS take steps to ensure payment procedures are adhered to.

Internal audit

67. 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.

68. Our review of internal audit concluded that the internal audit service provided by PricewaterhouseCoopers (PwC) operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

69. The internal audit plan for 2015/16 is complete and we have reviewed all reports including the annual assurance report issued in April 2016. The plan focused on wider dimension areas providing assurance on key projects, corporate initiatives and management information and as such we did not place formal reliance on their work in relation to the financial statements.

Arrangements for the prevention and detection of fraud

70. RoS is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We reviewed and reported on these arrangements and have concluded that there are effective arrangements for the prevention and detection of fraud.

National Fraud Initiative in Scotland

71. RoS participate in the latest National Fraud Initiative (NFI). The NFI is a counter-fraud exercise that is coordinated by Audit Scotland every two years. It uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error.

72. Overall, 61 data matches were identified for further investigation by RoS. This work has now been completed and no issues have arisen. The exercise provides valuable assurance as part of RoS' fraud prevention arrangements.

73. In June 2016, we published our findings from the latest NFI exercise. Our work found that a total of almost £17 million worth of fraud and error across services in Scotland in the two years since the exercise was last conducted.

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

74. 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 consider whether bodies have adequate arrangements in place and have concluded that appropriate arrangements exist within RoS.

Best Value

Arrangements for securing Best Value

75. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of best value. Where such requirements are not specified we may, in conjunction with RoS agree to undertake local work in this area.

76. We did not undertake any specific work in this area during 2015/16. RoS reviews whether it is meeting Best Value (BV) obligations on a six-monthly basis in a paper presented to, and reviewed by, the Audit and Risk Committee, the most recent of which was considered in February 2016. The review evidenced RoS' current adherence to BV principles and sets out its' future plans demonstrating a commitment to continuous improvement.

Local performance audit reports

Workforce planning

77. Workforce planning is the process that organisations use to make sure they have the right people with the right skills in the right place at the right time. The availability and suitability of staff are important factors in RoS' capacity to provide an efficient service.

78. During 2015/16 auditors were asked to undertake work reviewing workforce planning arrangements in place in all public bodies in Scotland. This follows on from our 2013 report, *Scotland's public sector workforce.*

79. The report recommended that public bodies should develop organisation-wide workforce plans. This helps bodies plan strategically and ensures that workforce changes in one area do not have unintended effects on others.

80. RoS have a dedicated Business Planning unit who carry out work to identify the organisation's operational resourcing requirements on a day-to-day level. They are in the process of developing a business planning model which can be used to forecast resourcing needs across a medium-term timescale. The model can be altered to reflect changes in demand caused by economic shocks or trends. The model is used to generate cost forecasts which underpin RoS' three-year rolling corporate plan.

81. An effective workforce plan should cover data and information about an organisation's existing workforce (age, grade, skills profiles) and establish plans for aligning it to their future resourcing requirements (i.e. learning & development, recruitment, well-being). RoS have drafted a *People@RoS* strategy which touches on these areas but does not include any workforce data.

82. The Business Transformation Programme will oversee fundamental change to RoS' operational processes and consequentially there will be significant changes in resourcing requirements and skills needed. Following a review recommendation, an Operational

Development project was established in 2016 under the programme to create “business readiness plans” across the organisation and to develop a targeted operating model. This involved communicating workforce changes to employees.

83. RoS would benefit from co-ordinating all of this activity together into the creation of an organisation-wide workforce plan. This can cover both single and multi-year timeframes and should be reviewed at least annually. The plan should include scenario planning to help identify the potential impact on workforce plans of changes in available finances, skills required or demand for services and should be closely aligned with long term financial plans The workforce plan should be developed following consultation with staff and other stakeholders and be subject to scrutiny by relevant committees and the Board. RoS may wish to consider our good practice guidance in developing their workforce plan.

Appendix IV – Action Plan No. 6

National performance audit reports

84. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, a number of reports were issued as outlined in Appendix III. These included:

- An update on the Implementation of the Scotland Act 2012, relevant to RoS’ role in the collection of Land & Buildings Transaction Tax
- An update on Managing ICT contracts in central government, this included a case study assessing the changes in RoS’ ICT management arrangements since the original report
- An update on the Common Agricultural Policy Futures Programme, this outlines the challenges and difficulties experienced by the Scottish Government in implementing a new IT system.

Appendix I: Significant audit risks

The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
Fraud and management override of controls 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	We analysed material journals processed during the year and reviewed their appropriateness. We have tested significant accounting estimates to identify any evidence of management bias.	Our audit procedures did not identify any evidence of management override of controls.
Fraud and revenue recognition ISA 240 requires an auditor to plan their audit work on the presumption that there is a risk of fraud in relation to revenue recognition. RoS receive significant amounts of income from registration and commercial services.	We confirmed that key internal controls were operating during the year and conducted detailed testing of revenue transactions.	Our substantive testing of income transactions did not identify any incidents of fraud relating to revenue recognition.

Audit Risk	Assurance procedure	Results and conclusions
Work in Progress valuations WIP calculations are made using complicated linked spread-sheets, and require average cost calculations that include a degree of estimation. Difficulties encountered in processing TP registrations will increase the value of the WIP stock and provision figures in the financial statements increasing the risk of a material misstatement	We reviewed the working papers used to calculate the WIP balances within the financial statements. We Identified the key figures used in the calculation and agreed them to source documentation. We considered the appropriateness of any estimates used to apportion costs to a particular registration product.	As reported in Table 1, our audit procedures identified two errors within the WIP spreadsheets. Management corrected both errors requiring adjustments to financial statements. There was, as expected, an increase in the stock of TP registrations in progress at the year end. This had the effect of increasing the provision required to cover the estimated losses. We conclude that the unit cost figures used in the calculation of this balance are reasonable.

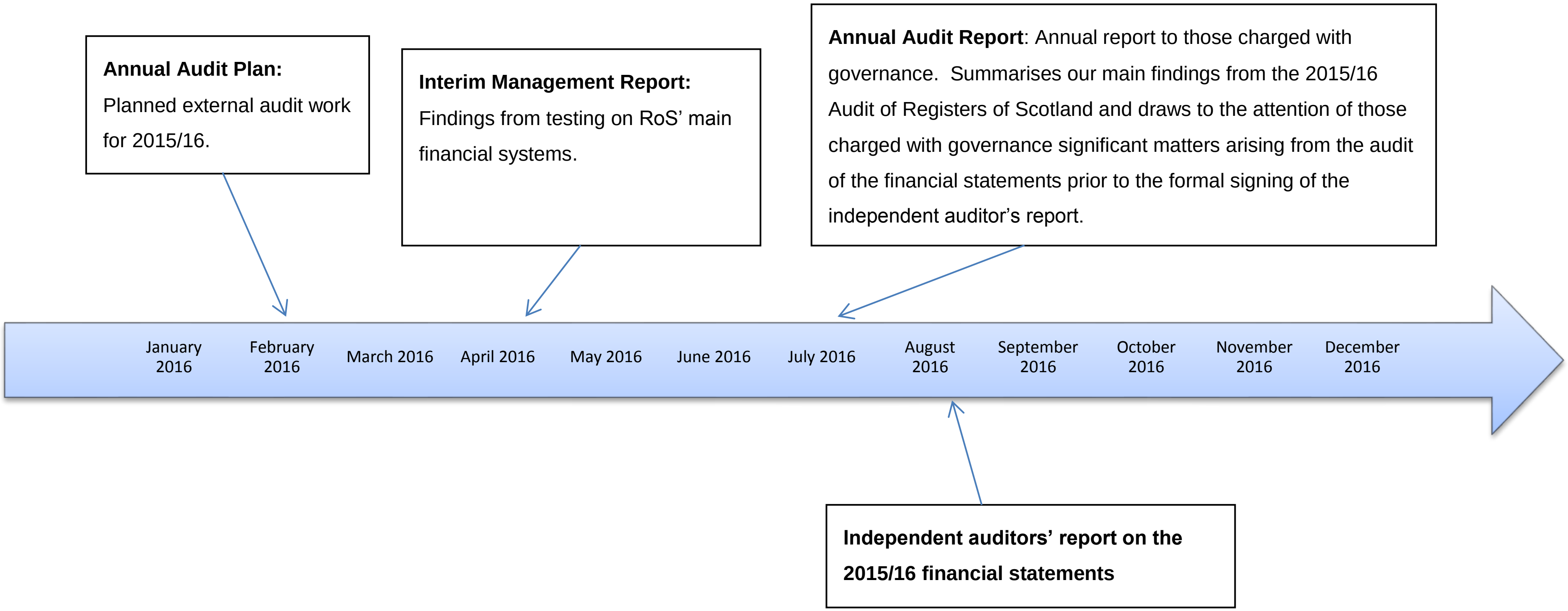
Audit Risk	Assurance procedure	Results and conclusions
Replacement of the non-current asset register (NCAR) RoS plan to switchover to a new IT system for maintaining their NCAR in February 2016. Responsibility for NCA within the RoS finance team has changed following the departure of a senior staff member. These circumstances have increased the risk that NCA valuations and depreciation charges contain material error.	We performed substantive audit procedures on the 2015/16 asset values and depreciation calculations. We reviewed the reconciliations between the previous NCAR, the new NCAR and the general ledger.	The transfer to the new asset register was completed in March 2016, as a result the old asset register was used to calculate depreciation charges for the year. Our audit testing did not identify any issues with the depreciation charges or valuation of the tangible and intangible balances in the financial ledger. Overall cost and accumulated depreciation totals in the new NCAR do not reconcile with the financial ledger. We understand this will be rectified during 2016/17.
Segmental Reporting In order to maintain FReM compliance, RoS must apply IFRS 8 Operating Segments in full. Commercial income for 2015/16 is likely to exceed the 10 per cent threshold, requiring RoS to include segmental reporting disclosures in their annual accounts.	We reviewed segmental reporting disclosures and assessed compliance with IFRS 8. We agreed the figures used to supporting documentation and assessed the reasonableness of the segmental split and cost allocation.	RoS have included segmental reporting disclosures for the first time within the 2015/16 accounts. They segmented the organisation based on their statutory and non-statutory revenue streams and we have concluded that the split is reasonable. Our review of the notes identified a number of areas where further disclosure narrative was needed to enhance compliance with IFRS 8, which were included in the final version of the accounts.

Audit Risk	Assurance procedure	Results and conclusions
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
Digital Transformation Programme RoS is undertaking an ambitious programme of IT projects designed to digitise their operational procedures over the next two years. Currently senior IT roles are filled by staff employed on fixed term contracts due to expire part way through the programme. IT programmes of this scale and ambition carry an inherent risk of failure and cost over-run.	We discussed the programme with key staff within the IT, project management and procurement departments We reviewed the key programme documentation including board minutes, business cases and gateway reviews. We undertook detailed testing of key revenue and capital expenditure relating to the programme	RoS launched its Digital Transformation Programme in January 2015. In recognition of the level of general business impact, this was renamed as the Business Transformation Programme in response to a recommendation from a Gateway Review in January 2016, which also recorded a delivery assessment of "Green/Amber". Our review of programme board papers found that RoS are reporting that the programme remains on target and within budget.

Audit Risk	Assurance procedure	Results and conclusions
Cyber Security Maintaining the land register is a key function in facilitating economic activity in Scotland. There is a risk that access to IT systems or the integrity of the registers could be compromised as a result of a cyber attack, restricting the ability to update the registers. Current business continuity plans demonstrate that only a partial disaster recovery system is in place.	We reviewed the Corporate Risk Register to ensure that the risks relating to the potential of cyber attacks were being appropriately managed. We discussed with IT management the approaches being taken to monitor and mitigate cyber risks, and improve IT disaster recovery capabilities.	We verified that disaster recovery and cyber security are subject to regular review by senior management, as noted in the risk register. An early project within the Business Transformation Programme has been the deployment of new private cloud infrastructure. This has improved RoS disaster recovery capabilities, and when all legacy systems are fully migrated to the new infrastructure, the risk of service interruption in the event of a disaster should be significantly reduced. In January 2016 both ISO27001 and ISO22301 certifications were successfully retained, providing further assurance about the capabilities of both the information security and business continuity management systems.

Audit Risk	Assurance procedure	Results and conclusions
Long term planning Both the DTP and LRC will have significant implications for RoS over the next decade Projects will require significant resources requiring funding from RoS' retained profits, yet once completed RoS will require a very different size and profile of workforce Without detailed long-term financial planning there is a risk of non-achievement due to funding constraints or a risk that the project threatens RoS' on-going financial sustainability. Without developing detailed workforce plans at both organisational and departmental levels there is an increased risk that the efficiency savings envisaged are not realised.	We monitored the governance and overall progress of longer term planning developments including key LRC and DTP project documents We reviewed the 2016-2019 corporate plan and held discussions with key staff involved in business planning and workforce strategy	RoS have continued to set out their financial plans on a rolling three-year cycle. An interim Head of Financial Strategy has been appointed and will work on developing a longer-term financial strategy. LRC and the DTP are still in the early stages and current business cases contain a number of significant assumptions when estimating the financial implications of the programmes. RoS are continuing to assess the implications for their workforce and are taking steps to communicate this to all staff. Our conclusions on this are outlined in paragraphs 73 to 79.
Changes to the 2015/16 FReM The section of the 2015/16 FReM outlining the form and content of the annual report has been extensively re-written. There is a risk that the disclosures may not be complete or comply with the spirit of the FReM.	We assessed the Performance and Accountability Reports against FReM requirements and made recommendations to enhance disclosures	Following our review, RoS made some presentational changes and added additional content to both the Performance and Accountability Reports. We concluded that disclosures were in line with the revised FReM.

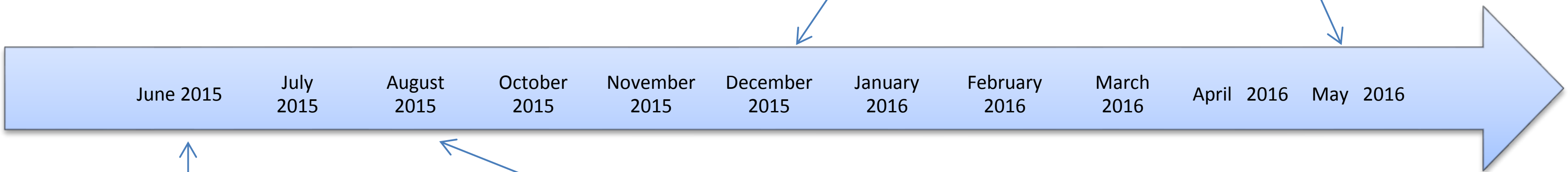
Appendix II: Summary of local audit reports 2015/16



Appendix III: Summary of Audit Scotland national reports 2015/16

Implementing the Scotland Act 2012 – an update (published December 2015) - This report assessed how effectively Revenue Scotland implemented, and is collecting, the two devolved taxes introduced in April 2015. It also examined how the Scottish Government is working with HM Revenue and Customs to prepare to introduce the Scottish rate of income tax in April 2016, and looked at how the Scottish Government is developing its financial management and reporting.

Common Agricultural Policy Futures programme: an update (published May 2016) – A Scottish Government programme set up to deliver complex agricultural reforms and financial support to rural workers continues to have serious cost and operational issues, and is unlikely to deliver value for money.



Managing ICT contracts in central government: an update (published June 2015) - This report reviewed the progress that the Scottish Government and central government bodies had made against the recommendations in our previous report on managing ICT contracts.

Scotland's public sector workforce: Impact report (published August 2015) - This report summarised the impact of the Audit Scotland report on 'Scotland's public sector workforce', published on 28 November 2013 and the related good practice guide.

Appendix IV: Action plan

No. AS ref.	Page	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	9	**Work-in-progress (WIP) calculations:** WIP calculations are complex and are finalised immediately prior to the issue of the draft accounts for audit. Audit testing identified two significant errors requiring adjustments in the 2015/16 financial statements. The calculations are not currently subject to secondary review. **Risk:** The value, complexity and timing of WIP calculations means there is a risk of that valuations may be misstated. **Recommendation:** RoS should strengthen controls around WIP calculations by implementing a process where calculations are reviewed and checked by someone out-with their preparation. This would help reduce the risk of error which is inherent in the use of spread-sheets.	Agreed. Additional time will be built into the process to allow for independent checking. Further internal checks will also be built into the spreadsheets to highlight possible errors.	Stephen Welham, Head of Finance November 2016

No. AS ref.	Page	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
2.	10	**Payment procedures:** Audit testing identified two payments which had not been processed correctly through the financial ledger. Adjustments were subsequently required to correct the accounts. **Risk:** Circumventing procedures increases the risk of error occurring in the financial statements. **Recommendation:** RoS should review payment procedures to ensure future payments are only made once they have been processed through the financial ledger.	Agreed. Procedures have been reviewed and better processes identified and new desk notes circulated. Checks will be carried out to ensure team is carrying out the new process.	Stephen Welham, Head of Finance August 2016
3.	10	**Withdrawn registration fees:** Included within the trade payables balance is approximately £857,000 of fees received relating to withdrawn registrations. Around £438,000 relates to withdrawn registrations older than 60 days with some dating back to before 2014. **Risk:** There is a risk that RoS are holding fees which it is not entitled to, or failing to recognise sales for submitted registrations. **Recommendation:** A clear policy for refunding fees received relating to withdrawn applications should be implemented and system changes developed to ensure refunds are made on a timely basis.	This balance is being actively monitored and greater resource allocated to deal with it. New processes have been developed to make the investigation and refunding more efficient. The policy aim is to have minimal balance over 60 days.	Stephen Welham, Head of Finance October 2016

No. AS ref.	Page	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
4.	11	**VAT review:** RoS commissioned a VAT review from an external contractor. The review highlighted a number of areas where VAT treatment may have led to an under or over recovery of VAT from HMRC. RoS have only partially responded to the reports recommendation so far. **Risk:** There is a risk that RoS may continue to either over or under-pay VAT by applying the incorrect treatment to payments. **Recommendation:** RoS should develop an action plan to consider and implement, where appropriate, the report’s recommendations. This should include seeking clarification from HMRC over the correct treatment for key items of expenditure.	Agreed. We will develop a plan to implement the report's recommendations. We have carried out initial calculations of the under and over recovery and will contact HMRC in relation to these.	Stephen Welham, Head of Finance September 2016

No. AS ref.	Page	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
5.	12	**Voluntary exit authorisation:** Where staff members apply for voluntary severance, a business case to assess the costs and benefits should be established to ensure decisions represent value for money and align with the organisation's future workforce plans. The assessment, decision and authorisation of exit package payments to the three employees was not sufficiently documented. **Risk:** There is a risk that decisions over staff departures using voluntary exit schemes may not represent value for money or be in the interests of organisational workforce planning. There is also a risk of irregular payments being made should appropriate documentation not be retained on file. **Recommendation**: All applications for departures under voluntary exit schemes should only be authorised following an assessment of the costs involved and workforce implications. The assessment and approval should be documented and retained on file.	Agreed. In line with current procedures, a business case for a voluntary exit (VE) scheme is prepared for RoS Board consideration & approval. Established policy and procedures are in place to support EMT & HROD team in the administration of any scheme. It is acknowledged that the full administrative process was not followed for these three employees. HROD will ensure that all VE applications follow the established process to ensure the documentation is in order and retained on file.	Billy Harkness, Corporate Services Director Immediately.

No. AS ref.	Page	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
6.	23	**Workforce planning**: Currently RoS undertake detailed workforce planning activity to support its rolling three-year corporate plan. However the activity is not being used to create an organisation-wide strategic workforce plan. An effective workforce plan should cover data and information about the organisation's existing workforce (i.e. age, grade, skills profiles) and establish plans for aligning it to their future resourcing requirements. **Risk**: Without an effective organisation-wide workforce plan, there is a risk that workforce planning may be uncoordinated leading to decisions in one area of the organisation having unintended consequences in another area. **Recommendation**: RoS should produce an organisational-wide workforce plan which maps its current workforce against the organisation's resourcing requirements over the short, medium and long-term. The plan should include scenario planning to help identify the potential impact on workforce plans of changes in available finances, skills required or demand for services. Such a plan should be developed following consultation with staff and other stakeholders.	Agreed. RoS is addressing this issue: • Short-term capacity and workforce plans are reassessed (number of staff by grade) during the quarterly forecast. • Strategic workforce planning models will be extended from number of staff by grade to include other key variables (e.g. skills, age) as appropriate to the business needs. • Capacity plans & the related workforce plan at different horizons will be reassessed as needed, to reflect changes in projected demands and supply capabilities.	Billy Harkness, Corporate Services Director Neil Cook, Head of Financial Strategy Corporate Plan 2017