

# Scottish Housing Regulator

2018/19 Annual Audit Report to the  
Board and the Auditor General for  
Scotland

June 2019





# Table of contents

---

1. Key messages	<b>1</b>
2. Introduction	<b>3</b>
3. Annual report and accounts	<b>6</b>
4. Wider scope	<b>13</b>
5. Appendices	<b>18</b>



# 1. Key messages

---



## Annual accounts audit

The Scottish Housing Regulator's annual report and accounts for the year ended 31 March 2019 are due to be approved by the Board on 6 August 2019.

We are due to report within our independent auditor's report unqualified opinions on the annual accounts, the regularity of transactions and on other prescribed matters. There were no matters which we are required to report by exception.

The annual report and accounts and supporting schedules were of a good standard. Our thanks go to management and staff at SHR for their assistance with our work.

## Wider scope audit

As outlined in our External Audit Plan, our annual audit work in respect of our wider scope audit responsibilities was restricted to:

- Audit work to allow conclusions to be made on the appropriateness of the disclosures in the Annual Governance Statement; and
- Consideration of the financial sustainability of the organisation and the services that it delivers over the medium and longer term.

Our conclusions and key observations are set out below:



### Governance statement

- We are satisfied that the Governance Statement complies with Scottish Ministers' guidance and that the content is consistent with the financial statements.
- SHR has appropriate systems in place to record, process, summarise and report financial and other relevant data. We have not identified any significant weaknesses or governance issues in the SHR's accounting and internal control systems.



### Financial sustainability

- Overall, SHR has effective arrangements in place for financial planning and monitoring.
- SHR has prepared medium term financial projections. A balanced budget has been prepared for 2019/20 on the assumption that a full staffing compliment will not be achieved until the middle of the financial year. Scenario analysis shows that if all posts were filled for the entire year, SHR would incur an overspend of around £269,000. At a full staffing compliment, SHR will face potentially significant overspends in 2020/21 and beyond if a flat cash allocation is received.
- Management had committed to presenting a Workforce Strategy to the Board in December 2018 based on the new Regulatory Framework. During 2018 there was a re-organisation of the staffing structure and work was undertaken to analyse the resources required under the new Regulatory Framework with subsequent recruitment to a number of new posts. Further work will be required to fully develop a Workforce Plan. Given the significant level of financial pressure staff costs already present, robust workforce planning is key to ensuring SHR can operate effectively and efficiently, whilst supporting financial sustainability.

## Conclusion

This report concludes our audit for 2018/19. Our work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK) and Ethical Standards.

**Scott-Moncrieff**  
June 2019



## 2. Introduction

---

**This report is presented to those charged with governance and the Auditor General for Scotland and concludes our audit of the Scottish Housing Regulator for 2018/19.**

**We carry out our audit in accordance with Audit Scotland’s Code of Audit Practice (May 2016). This report also fulfils the requirements of International Standards on Auditing (UK) 260: Communication with those charged with governance.**

**At the Scottish Housing Regulator, the Audit and Risk Assurance Committee has been designated as “those charged with governance”.**

---



## Introduction

1. This report summarises the findings from our 2018/19 audit of the Scottish Housing Regulator (“SHR”).
2. We outlined the scope of our audit in our External Audit Plan, which we presented to the Audit and Risk Assurance Committee at the outset of our audit. The core elements of our work include:
  - an audit of the 2018/19 annual report and accounts and related matters;
  - consideration of SHR’s arrangements against the audit dimensions within the Code of Audit Practice (Exhibit 1); and
  - any other work requested by Audit Scotland.

### Exhibit 1: Audit dimensions within the Code of Audit Practice



3. SHR is responsible for preparing an annual report and accounts which show a true and fair view and for implementing appropriate internal control systems. The weaknesses or risks identified are only those that have come to our attention during our normal audit work, and may not be all that exist. Communication in this report of matters arising from the audit of the annual report and accounts or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.
4. The report contains an action plan with specific recommendations, responsible officers and dates for implementation. Senior management should assess these recommendations and consider their wider implications before deciding on appropriate actions. We give each recommendation a grading to help SHR assess their significance and prioritise the actions required.
5. We discussed and agreed the content of this report with the Director of Digital and Business Support. We would like to thank all management and staff for their co-operation and assistance during our audit.

### Confirmation of independence

6. International Standards on Auditing in the UK (ISAs (UK)) require us to communicate on a timely basis all facts and matters that may have a bearing on our independence.
7. We confirm that we will comply with the Financial Reporting Council’s (FRC) Revised Ethical Standard (June 2016). In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way.
8. We set out in Appendix 1 our assessment and confirmation of independence.



## Adding value through the audit

9. All of our clients demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to SHR through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the SHR promote improved standards of governance, better management and decision making and more effective use of resources.

## Feedback

10. Any comments you may have on the service we provide, the quality of our work and our reports would be greatly appreciated at any time. Comments can be reported directly to the audit team or through our online survey:  
[www.surveymonkey.co.uk/r/S2SPZBX](http://www.surveymonkey.co.uk/r/S2SPZBX)
11. While this report is addressed to SHR and the Auditor General for Scotland, it will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)



# 3. Annual report and accounts

---

**SHR's annual report and accounts are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources.**

**In this section we summarise the findings from our audit of the 2018/19 annual report and accounts.**

---





# Annual report and accounts

## An unqualified audit opinion on the annual report and accounts

The annual report and accounts for the year ended 31 March 2019 are due to be considered by the Audit and Risk Assurance Committee on 19 June 2019, and approved by SHR's Board on 6 August 2019. We intend to report unqualified opinions within our independent auditor's report. We did not identify any significant adjustments to the unaudited annual report and accounts.

SHR has good administrative processes in place to prepare the annual report and accounts and the required supporting working papers.

## Overall conclusion

### An unqualified audit opinion on the annual report and accounts

12. The annual report and accounts for the year ended 31 March 2019 are due to be considered by the Audit and Risk Committee on 19 June 2019 and approved by SHR's Board on 6 August 2019. We intend to report within our independent auditor's report:
  1. An unqualified opinion on the financial statements;
  2. An unqualified opinion on regularity; and
  3. An unqualified opinion on other prescribed matters.
13. We are also satisfied that there were no matters which we are required to report by exception.

### Good administrative processes were in place

14. We received the unaudited annual report and accounts and supporting papers of a high standard, in line with our agreed audit timetable. Our thanks go to staff at SHR for their assistance with our work.
15. The annual report and accounts will be submitted to the Scottish Government and Auditor General for Scotland by the 31 October 2019 deadline.

## Our assessment of risks of material misstatement

16. The assessed risks of material misstatement described in Exhibit 2 are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the audit team. Our audit procedures relating to these matters were designed in the context of our audit of the annual report and accounts as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the annual report and accounts is not modified with respect to any of the risks described in Exhibit 2.



## Exhibit 2 – Our assessment of risks of material misstatement and how the scope of our audit responded to those risks

### 1. Management override

In any organisation, there exists a risk that management has the ability to process transactions or make adjustments to the financial records outside the normal financial control processes. Such issues could lead to a material misstatement in the financial statements. This is treated as a presumed risk area in accordance with ISA (UK) 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements*.

*Excerpt from the 2018/19 External Audit Plan*

17. We have not identified any indications of management override in the year. We have reviewed SHR's accounting records and obtained evidence to ensure that transactions outside the normal course of business were valid and accounted for correctly. We have also reviewed management estimates and the journal entries processed in the period and around the year end. We did not identify any areas of bias in key judgements made by management and judgements were consistent with prior years.

### 2. Revenue recognition

Under ISA (UK) 240- *The auditor's responsibilities relating to fraud in an audit of financial statements* there is a presumed risk of fraud in relation to revenue recognition. The presumption is that SHR could adopt accounting policies or recognise revenue transactions in such a way as to lead to a material misstatement in the reported financial position.

*Excerpt from the 2018/19 External Audit Plan*

18. At the planning stage of our audit cycle, we reported that we did not believe the risk of fraud in revenue recognition was material to the annual accounts and we therefore rebutted this risk. SHR does not undertake any income generating activities; funding from the Scottish Government is their only source of income. This position has been reviewed throughout the audit and the conclusion has remained appropriate.

### 3. Risk of fraud in the recognition of expenditure

In 2016, the Public Audit Forum issued Practice Note 10 "The Audit of Public Sector Financial Statements" which applies to the audit of public sector financial statements for periods commencing after June 2016. This Practice Note recognises that most public sector bodies are net spending bodies and notes that there is an increased risk of material misstatement due to improper recognition of expenditure.

*Excerpt from the 2018/19 External Audit Plan*

19. While we did not suspect incidences of material fraud and error, we evaluated each type of expenditure transaction and documented our conclusions. We have gained reasonable assurance on the completeness and occurrence of expenditure and are satisfied that expenditure is fairly stated in the annual accounts. To inform our conclusion, we carried out testing to confirm that SHR's policy for recognising expenditure is appropriate and has been applied consistently throughout the year.



## Our application of materiality

20. The assessment of what is material is a matter of professional judgement and involves considering both the amount and the nature of the misstatement. This means that different materiality levels will be applied to different elements of the financial statements.
21. Our initial assessment of materiality for the annual accounts was £73,000 and it remained at this level throughout our audit. This equates to approximately 1.8% of SHR's 2018/19 net operating cost. Achieving a breakeven position is a key target for SHR and one of the principal considerations for the users of the accounts when assessing financial performance.

### Performance materiality

22. Performance materiality is the amount set by the auditor for each financial statement area, to reduce to an appropriately low level the probability that collectively any uncorrected and undetected misstatements are less than materiality for the financial statements as a whole.
23. We set a performance (testing) materiality for each area of work which was based on a risk assessment for the area. We perform audit procedures on all transactions and balances that exceed our performance materiality. This means that we are performing a greater level of testing on the areas deemed to be of significant risk of material misstatement. Performance testing thresholds used are set out in the table below:

	Area risk assessment		
	High	Medium	Low
Performance materiality	33	40	51

24. We agreed with the Audit and Risk Assurance Committee that we would report on all material corrected misstatements, uncorrected misstatements with a value in excess of £4,000, as well as other misstatements below that threshold which, in our view, warranted reporting on qualitative grounds. We also report to the Audit and Risk Assurance Committee on disclosure matters that we identified when assessing the overall presentation of the annual accounts.

## Audit differences

25. We are pleased to report that there were no material adjustments or unadjusted differences to the unaudited annual accounts. We identified some

disclosure and presentational adjustments during our audit, which have been reflected in the final set of accounts.

## Board representations

26. We have requested that a signed representation letter be presented to us at the date of signing the financial statements. This letter is to be signed by the Accountable Officer on behalf of the Board.

## An overview of the scope of our audit

27. The scope of our audit was detailed in our External Audit Plan, which was presented to the Audit and Risk Assurance Committee in March 2019. The plan explained that we follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Board. This ensures that our audit focuses on the areas of highest risk. Planning is a continuous process and our audit plan is subject to review during the course of the audit to take account of developments that arise.
28. At the planning stage we identified the significant risks that had the greatest effect on our audit. Audit procedures were then designed to mitigate these risks.
29. Our standard audit approach is based on performing a review of the key financial systems in place, substantive tests and detailed analytical procedures. Tailored audit procedures, including those designed to address significant risks, were completed by the audit fieldwork team and the results were reviewed by the audit manager and audit partner. In performing our work we have applied the concept of materiality, which is explained earlier in this report.

## Other matters identified during our audit

30. During the course of our audit we noted the following:

### Other information in the annual report and accounts

31. "Other information" in the annual report and accounts comprises any information other than the financial statements and our independent auditor's report. We do not express any form of assurance conclusion on the "other information" except as specifically stated below.

### The performance report

32. The performance report provides information on the entity, its main objectives and strategies and the principal risks that it faces. It comprises an



overview of the organisation and a detailed summary of how the entity measures performance.

33. We have concluded that the performance report has been prepared in accordance with directions from Scottish Ministers and is consistent with the financial statements.

### The accountability report

34. The accountability report is required in order to meet key parliamentary accountability requirements and comprises three sections: a corporate governance report (including the governance statement), remuneration and staff report, and a parliamentary accountability report.
35. We have obtained adequate evidence that the information provided in the remuneration and staff report is in agreement with accounting records and has been prepared in line with ministerial guidance.
36. We have reviewed the annual governance statement and have found that it is consistent with the financial statements and has been prepared in accordance with Scottish Ministers' guidance.
37. Overall, the disclosures in the governance statement are consistent with this and internal audit's conclusion for 2018/19.

### Internal audit

38. SHR's internal audit function is provided by the Scottish Government. We have taken cognisance of the work of internal audit in forming our opinion on the appropriateness of the disclosures in the annual governance statement.

### Regularity

39. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the annual report and accounts. We did not identify any instances of irregular activity.

### Software licences

40. As at 31 March 2019, the intangible asset register included fully amortised software licences with an original cost of £123,000. Management confirmed that a number of these licences are no longer in use. However, they were unable to easily identify these and the associated original cost. As a result, these have not been removed from the intangible asset register and are still included with a nil net book value.

41. SHR should analyse their software licences to ensure any that are no longer in use are clearly identified and removed from the asset register in a timely manner. Going forward, SHR should review their asset registers on an annual basis and remove any assets no longer in use.

42. A high number of fully depreciated or amortised assets still in use suggests that the estimated useful life applied is inappropriate. As raised in our 2017/18 Annual Report on the audit, SHR should review their accounting policies and standard assets lives to ensure they remain appropriate.

### Action plan point 1

### Financial systems – user access controls

43. As part of our audit, we considered the controls SHR has in place around key financial systems, including user access controls. Scottish Government Shared Services are responsible for managing user access rights based on the information SHR provide. Our review highlighted that SHR do not notify all of the appropriate departments within Scottish Government Shared Services when an employee leaves the organisation. Instead, this information is shared and processed on an annual basis.
44. If user access rights are not revoked in a timely manner, there is a risk that inappropriate access or authorisation occurs within the key purchasing or accounting system.
45. We recommend that SHR ensure the timely removal of user access rights for all employees leaving the organisation. SHR should review all user access rights on an annual basis to ensure these remain appropriate.

### Action plan point 2

### Looking forward – IFRS 16 Leases

46. IFRS 16 Leases will be effective from 1 April 2020. IFRS 16 Leases will lead to a substantial change in accounting practice for lessees where the current distinction between operating and finance leases will be removed. Instead, it requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value. A lessee will recognise a right-of-use asset representing its right to use the underlying leased property, and a lease liability representing the lessee's obligation to pay for that right.
47. There are new requirements for measurement of the lease liability where it will initially be measured at



the present value of the lease payments payable over the lease term but may rise to reflect any reassessment or lease modifications, or revised in-substance fixed lease payments.

48. The Finance manager presented a paper to the ARAC (Audit and Risk Assurance Committee) regarding the accounting treatment of SHR's sub-lease of accommodation under IFRS. Other than this the only other recognised lease is of a low value asset.

## Qualitative aspects of accounting practices and financial reporting

49. During the course of our audit, we consider the qualitative aspects of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the annual accounts. The following observations have been made:

Qualitative aspect considered	Audit conclusion
The appropriateness of the accounting policies used.	We consider the accounting policies, which are disclosed in the financial statements, to be appropriate and in line with the Government Financial Reporting Manual.
The timing of the transactions and the period in which they are recorded.	We did not identify any concerns over the timing of transactions or the period in which they were recognised.
The appropriateness of the accounting estimates and judgements used.	We identified one issue with the appropriateness of asset depreciation rates (refer to action point plan 1). However, we concluded that any revision to the useful life of these assets would be immaterial to the annual accounts.  We are satisfied with the appropriateness of other accounting estimates and judgements used in the preparation of the annual accounts.
The appropriateness of the going concern assumption	We have reviewed the detailed financial forecasts for 2018/19. Our understanding of the legislative framework and activities undertaken provides us with sufficient assurance that SHR will continue to operate for at least 12 months from the signing date.
The potential effect on the annual accounts of any uncertainties, including significant risks and related disclosures that are required.	We have not identified any uncertainties, including any significant risk or required disclosures, which should be included in the annual accounts.
The extent to which the annual accounts have been affected by unusual transactions during the period and the extent that these transactions are separately disclosed.	From the testing performed, we identified no significant unusual transactions in the period.
Apparent misstatements in the management commentary or material inconsistencies with the financial statements.	The annual report contains no material misstatements or inconsistencies with the financial statements.
Any significant annual accounts disclosures to bring to your attention.	All the disclosures required by relevant legislation and applicable accounting standards have been made appropriately. This includes Governance Statement disclosure as referred to previously.



Qualitative aspect considered	Audit conclusion
Disagreement over any accounting treatment or annual accounts disclosure.	While disclosure and presentational adjustments were made during the audit process there was no material disagreement during the course of the audit over any accounting treatment or disclosure.
Difficulties encountered in the audit.	There were no significant difficulties encountered during the audit. However, we did not receive the remuneration report figures until after our audit fieldwork. This was outwith SHR's control and due to a delay in receiving required pension information from MyCSP.



# 4. Wider scope

---

Following consideration of the size, nature and risks of SHR, the application of the full wider scope audit is judged by us not to be appropriate. Our annual audit work on the wider scope has therefore been restricted to:

- Audit work to allow conclusions to be made on the appropriateness of the disclosures in the governance statement; and
  - Consideration of the financial sustainability of the organisation and the services that it delivers over the medium and longer term.
-



## Wider scope conclusions



### Governance statement

We are satisfied that the Governance Statement complies with Scottish Ministers' guidance and that the content is consistent with the financial statements.

### Financial sustainability

SHR has effective arrangements in place for short and medium term (3 year) financial planning. The Board has approved both revenue and capital budgets for 2019/20.



Staff costs continue to be a significant pressure. SHR deem the financial position in 2019/20 to only be financially manageable on the assumption that a full staffing compliment will not be achieved until the middle of the financial year. At a full staffing compliment, SHR will likely face potentially significant overspends in 2020/21 if a flat cash allocation is received.

Management had committed to presenting a Workforce Strategy to the Board in December 2018 based on the new Regulatory Framework. During 2018 there was a re-organisation of the staffing structure and work was undertaken to analyse the resources required under the new Regulatory Framework with subsequent recruitment to a number of new posts. Further work will be required to fully develop a Workforce Plan. Given the significant level of financial pressure staff costs already present, robust workforce planning is key to ensuring SHR can operate effectively and efficiently, whilst supporting financial sustainability.

## Our approach to the wider scope audit

50. Our approach to the wider scope audit (as set out in our 2018/19 External Audit Plan) builds upon our understanding of SHR which we developed from previous years, along with discussions with management and review of committee minutes and key strategy documents.
51. During our audit we also considered the following risk areas as they relate to SHR:

- EU withdrawal
- Changing landscape of public financial management
- Dependency on key suppliers
- Openness and transparency

Overall we concluded that SHR has appropriate arrangements in place in respect of these areas as noted below:

### Impact of EU withdrawal

SHR was well prepared for leaving on the original due date of 29 March 2019 and has been able to demonstrate consideration of each of the above areas. This included a review of the workforce, relevant legislation and current dealings with the EU.

Short-term challenges in the event of EU withdrawal primarily relate to the impact this may have on Registered Social Landlords (RSLs) and the subsequent response required from SHR as their regulatory body. To minimise this impact, SHR have continued to work with the sector to explore this risk and ensure it is appropriately considered within RSLs' business planning and risk management arrangements.





### Changing landscape of Financial Management

The Scottish Government's five-year outlook for the Scottish budget set out in the Medium Term Financial Strategy provides useful context for financial planning. The new budget process places greater emphasis on assessing outcomes and the impact of spending.

SHR's new Regulatory Framework was published in February 2019 and came into effect on 1 April 2019. The Framework aims to ensure SHR's continued service delivery is financially sustainable. Work is underway to ensure that SHR has appropriate and sufficient resource in place to support its implementation

### Dependency on key suppliers

Following the collapse of Carillion, it became apparent that public sector bodies face significant risks where key suppliers are experiencing difficult trading conditions.

SHR is currently incurring significant IT spend in relation to the Business Intelligence System and their website (2018/19: £556,000). We confirmed that this is through a number of different contracts and suppliers which mitigates the risk to SHR.

### Openness and transparency

We consider SHR to exhibit good practice with respect to their openness and transparency arrangements through the following:

- Publication of Board minutes on SHR's website;
- Key publications including corporate plan, annual accounts and the Regulatory Framework are available on SHR's website;
- Up-to-date registers of interests are available on SHR's website for all Board members; and
- Range of methods used to communicate with stakeholders, including regular e-newsletters, publications and social media.

In December 2018, the Audit and Risk Assurance Committee reviewed their terms of reference against Scottish Government's updated Audit Committee Handbook. The Committee agreed to publish their minutes, terms of reference and list of members on SHR's website to further improve their openness and transparency arrangements.



### Governance statement

Our audit work includes consideration of the appropriateness of the disclosures in the governance statement.

52. We have reviewed the annual governance statement and have found that it is consistent with the financial statements and has been prepared in accordance with Scottish Ministers' guidance.
53. Overall, the disclosures in the governance statement are consistent with this and internal audit's conclusion for 2018/19.



### Financial sustainability

Financial sustainability looks forward to the medium and longer term to consider whether SHR is planning effectively to continue to deliver its services or the way in which they should be delivered.

### Significant audit risk

54. Our audit plan identified a significant risk in relation to financial sustainability under our wider scope responsibilities



## Financial sustainability

SHR has prepared medium term financial projections. Assuming a flat rate budget of £3.885million, SHR is projecting a shortfall of £61,000 in 2019/20 and £141,000 in 2020/21. Public sector budgets are under strain due to the end of the pay cap and the increasing uncertainty and complexity of the Scottish Government budgeting process. Staff cost account for 80% of SHR's expenditure and continue to be a significant pressure.

In addition, SHR are finalising their updated Regulatory Framework which will be implemented from 1 April 2019. This has challenged SHR to re-assess how it will fulfil its regulatory function. Significant financial and operational planning is required to ensure there is sufficient resource available to support this and ensure service delivery remains financially sustainable.

*Excerpt from the 2018/19 External Audit Plan*

55. SHR reported an underspend in 2018/19 of £135,000 against their revenue budget of £3.885million. This was largely due to delays in the recruitment programme and the subsequent high vacancy rate. We confirmed that SHR has a medium term financial plan in place which is aligned to the Corporate Plan. Our work and conclusions on the medium term financial and operational planning for 2019/20 onwards is set out below and notes the ongoing challenges SHR continues to face.

### Indicative 2019/20 budgets

56. As funding from the Scottish Government is SHR's only source of income, there is a greater degree of certainty over future funding streams than for some other public sector organisations who are involved in income generating activities. Therefore, the main focus for SHR is achieving a balanced financial plan to remain within the annual allocation.
57. SHR has been allocated a cash revenue budget of £4.085million in 2019/20, an increase of £200,000 compared to 2018/19. In addition, SHR has received £200,000 of capital funding and a non-cash allocation of £219,000 to cover depreciation and amortisation of non-current asset.
58. SHR has set a balanced budget for 2019/20, including £8,000 contingency for costs (0.2% of budget). Staff costs continue to be the most significant component of SHR's expenditure, accounting for 84% of the 2019/20 budget. The budget outlines key assumptions made in relation to each significant line of budgeted expenditure.
59. As funding from the Scottish Government is SHR's only source of income, there is a greater degree of certainty over future funding streams than for some other public sector organisations who are involved in income generating activities. Therefore, the main focus for SHR is achieving a balanced financial plan to remain within the annual allocation.
60. The lift of the public sector pay cap has continued to result in additional pressures. SHR has assumed a 4% pay increase for 2019/20, mirroring the actual pay award for 2018/19. Negotiations are still ongoing between Scottish Government and the unions to agree the uplift for 2019/20. SHR is continuing to monitor the position to ensure the agreed outcome is appropriately reflected in their 2019/20 budget.
61. As reported to the Board in March, the financial position in 2019/20 is deemed to only be financially manageable on the assumption that a full staffing compliment will not be achieved until the middle of the financial year. Scenario analysis shows that if all posts were filled for the entire year, this would result in an overspend of around £269,000. At a full staffing compliment, SHR will likely face potentially significant overspends in 2020/21 and beyond if a flat cash allocation is received.

### Staffing costs

59. In March 2019, SHR was informed that their employer pension contribution is likely to increase significantly in 2019/20. This is a direct result of changes announced by the UK Government as part of the scheme of valuations for public sector pensions and the government has committed to meeting some of these costs. As advised by the Scottish Government, SHR has budgeted on the basis of having to meet 50% of the cost from their

### Capital budget

62. In March 2019, the Board approved SHR's capital programme. The capital allocation of £200,000 is a result of SHR rolling forward a portion of their 2018/19 allocation that they were unable to spend in the year due to slippage in key projects.
63. £125,000 of the budget will be used to future-proof and enhance the resilience of the Business Intelligence System. Additional capital projects



include the development of a new website, the outcome of the CivTach challenge and the purchase of IT and office equipment.

## Regulatory framework review

64. The Regulatory Framework sets out how SHR fulfils its statutory responsibilities. The main aim of the Framework Review is for SHR to challenge how it fulfils its regulatory role and how it can ensure service delivery is financially sustainable. SHR have undergone significant work in 2018/19 to complete their review of the Regulatory Framework. The new Regulatory Framework was published in February 2019 and came into effect on 1 April 2019.
65. The new Framework has introduced a shift in how SHR will work with Registered Social Landlords and local authorities, putting landlord self-assurance at the heart of SHR's approach to regulation. It is therefore important that SHR has appropriate and sufficient resource in place to support its implementation and effectively operate under the new Regulatory Framework.
66. Management had committed to presenting a Workforce Strategy to the Board in December 2018, based on the new Regulatory Framework. Staff requirements have been considered as part of short and medium term financial planning. Throughout the financial year 2018/19 a number of reports were presented to the Board with regards to workforce resourcing under the new Regulatory Framework. SHR then engaged in a recruitment drive to take steps to ensure appropriate vacancies would be filled prior to the framework commencing on 1<sup>st</sup> April 2019. We recognise SHR has completed a number of tasks in preparing themselves for the new Regulatory Framework. However, there is still further work required to ensure a robust Workforce Strategy is developed and to merge all aspects of the workforce planning activities completed. This should include assumed vacancy/sickness rates, succession plans and alignment to support SHR's financial and operational planning.

### *Action plan point 3*



# 5. Appendices

---





## Appendix 1: Respective responsibilities of the Board and the Auditor

### Responsibility for the preparation of the annual report and accounts

It is the responsibility of the Board and the Chief Executive, as Accountable Officer, to prepare financial statements in accordance with the Government Financial Reporting Manual (FReM) issued by HM Treasury and the accounts directions issued by Scottish Minister under section 19(4) of the Public Finance and Accountability (Scotland) Act 2000.

#### In preparing the annual report and accounts, the Board and the Chief Executive, as Accountable Officer are required to:

- apply on a consistent basis the accounting policies and standards;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Financial Reporting Manual have not been followed where the effect of the departure is material;
- prepare the accounts on a going concern basis unless it is inappropriate to presume that SHR will continue to operate; and
- ensure the regularity of expenditure and income.

#### Board members are also responsible for:

- keeping proper accounting records which are up to date; and
- taking reasonable steps for the prevention and detection of fraud and other irregularities.

### Auditor responsibilities

#### We audit the annual report and accounts and give an opinion on whether:

- they give a true and fair view in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers of the state of the SHR's affairs as at 31 March 2019 and of its net expenditure for the year then ended;
- they have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2018/19 FReM ;
- they have been prepared in accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers;
- in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers, the Budget (Scotland) Act and the Public Finance and Accountability (Scotland) Act 2000;
- in all material respects, sums paid out of the Scottish Consolidated Fund for the purpose of meeting expenditure shown in the financial statements were applied in accordance with the Scotland Act 1998;
- the information given in the Performance Report for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers; and
- the information given in the Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers.

#### We are also required to report, if in our opinion:

- adequate accounting records have not been kept; or
- the annual accounts and the part of the Remuneration and Staff Report to be audited are not in agreement with accounting records; or



### We are also required to report, if in our opinion:

- we have not received all the information and explanations we require for our audit; or
- there has been a failure to achieve a prescribed financial objective.

## Wider scope of audit

The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.

The Code of Audit Practice frames a significant part of our wider scope responsibilities in terms of four audit dimensions: financial sustainability; financial management; governance and transparency; and value for money.

We have concluded that the full application is not appropriate due to the size of the organisation. As part of our annual audit we consider and report against:

- appropriateness of the disclosures in the governance statement; and
- financial sustainability of the body and the services that it delivers over the medium to longer term.

## Independence

International Standard on Auditing (UK) 260 "Communication with those charged with governance" requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence.

### Confirmation of independence

We confirm that we have complied with the FRC's Revised Ethical Standard (June 2016). In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way. In particular there are and have been no relationships between Scott-Moncrieff and SHR, its Board members and senior management that may reasonably be thought to bear on our objectivity and independence.



## Appendix 2: Action plan

Our action plan details the weaknesses and opportunities for improvement that we have identified during our audit.

### Action plan grading structure

To assist SHR in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated.

The rating structure is summarised as follows:

Grade	Explanation
<b>Grade 5</b>	Very high risk exposure - Major concerns requiring immediate attention.
<b>Grade 4</b>	High risk exposure - Material observations requiring management attention.
<b>Grade 3</b>	Moderate risk exposure - Significant observations requiring management attention.
<b>Grade 2</b>	Limited risk exposure - Minor observations requiring management attention
<b>Grade 1</b>	Efficiency / housekeeping point.



## Current year action plan

Action plan point	Issue & recommendation	Management comments
<p>1. Software licences</p> <p>Rating</p> <p><b>Grade 2</b></p> <p>Paragraph Ref</p> <p>42</p>	<p><b>Issue</b></p> <p>As at 31 March 2019, the intangible asset register included fully amortised software licences with an original cost of £123,000. Management confirmed that a number of these licences are no longer in use. However, they were unable to easily identify these and the associated cost. As a result, they have not been removed from the intangible asset register.</p> <p>As these assets are currently held with a nil net book value, there is no material impact on the primary statements.</p> <p><b>Recommendation</b></p> <p>SHR should review its software licences to ensure that any no longer in use are clearly identified and removed from the asset register in a timely manner.</p>	<p>We will review our software licences and remove from the asset register those that are no longer in use.</p> <p><b>Responsible officer:</b> Nigel Gregory</p> <p><b>Implementation date:</b> March 2020</p>
<p>2. Financial systems – user access controls</p> <p>Rating</p> <p><b>Grade 2</b></p> <p>Paragraph Ref</p> <p>45</p>	<p><b>Issue</b></p> <p>Scottish Government Shared Services are responsible for managing user access rights based on the information SHR provide. Our review highlighted that SHR do not notify the appropriate department within Shared Services on an employee leaving the organisation in a timely manner. Instead, this information is shared and processed on an annual basis.</p> <p><b>Risk</b></p> <p>If user access rights are not revoked in a timely manner, there is a risk that inappropriate access or authorisation occurs within the key purchasing or accounting system.</p> <p><b>Recommendation</b></p> <p>We recommend that SHR ensure the timely communication of employees leaving the organisation to support the appropriate removal of their user access rights. SHR should review all user access rights on an annual basis to ensure these remain appropriate.</p>	<p>We will review our approach to ensure consistency in removing staff user access rights from purchasing and accounting systems as staff leave and on an annual basis.</p> <p><b>Responsible officer:</b> Clare Nicolson</p> <p><b>Implementation date:</b> August 2019</p>





Action plan point	Issue & recommendation	Management comments
<p data-bbox="186 262 430 315">3. Workforce plan</p> <p data-bbox="186 336 430 388">Rating</p> <p data-bbox="186 441 430 493"><b>Grade 3</b></p> <p data-bbox="186 535 430 588">Paragraph Ref</p> <p data-bbox="186 609 430 651">66</p>	<p data-bbox="495 252 560 283"><b>Issue</b></p> <p data-bbox="495 283 917 514">To support the effective implementation of the revised Regulatory Framework, management committed to presenting a Workforce Strategy to the Board in December 2018. We have evidenced work completed in terms of understanding the resource needed under the new regulatory framework.</p> <p data-bbox="495 546 552 577"><b>Risk</b></p> <p data-bbox="495 577 917 724">Without robust workforce planning, there is a risk that SHR will not be able to operate effectively under the new Regulatory Framework whilst maintaining financial sustainability.</p> <p data-bbox="495 756 682 787"><b>Recommendation</b></p> <p data-bbox="495 787 917 997">SHR should incorporate the current work undertaken on staffing and bring this together in a robust Workforce Strategy. This should include future succession planning and expected vacancy rates to continue to meet balanced budgets moving forward.</p>	<p data-bbox="974 273 1396 472">We will develop a workforce strategy with a clear focus on the people and skills we need now and in the coming years. We will develop the strategy to build on the work we have done over the last year and in the context of the Scottish Government's budgetary process and the requirements of the Civil Service</p> <p data-bbox="974 525 1177 577"><b>Responsible officer:</b> Michael Cameron</p> <p data-bbox="974 609 1388 808"><b>Implementation date:</b> We will begin this project by the end of December 2019, by which time our current recruitment should be complete. An important part of the early phase will be to develop a timescale for the development and completion of the strategy.</p>



## Follow up of prior year recommendations

Of the two recommendations raised within our 2017/18 annual audit report, we note that one remains outstanding and one has been implemented. Details are given below.

### 1. Capital accounting policies and estimates

Initial rating	Issue & recommendation	Management comments
<b>Grade 2</b>	<p><b>Observation</b></p> <p>SHR adopts Scottish Government capital accounting policies and applies the same estimated useful life to SHR assets.</p> <p>As at 31 March 2018, the asset register included fully depreciated assets with an original cost of £337,000. We confirmed with management that SHR expect these assets to continue to be in use beyond 2018/19. This suggests that the estimated useful life applied is inappropriate and that SHR is overestimating the annual depreciation charge.</p> <p><b>Recommendation</b></p> <p>While we concluded that any revision to the useful life of these assets would be immaterial to the annual accounts, we encourage SHR to review its capital accounting policies and ensure these are relevant and appropriate for the assets held.</p>	<p>We will review our capital accounting policies and bring a paper to ARAC in March 2019 for approval, ahead of preparation of our 2018/19 accounts.</p> <p><b>Due Date:</b> March 2019</p>
Current status	Audit update	Management response
<b>Action outstanding</b>	<p>No review was undertaken in 2018/19 due to staffing pressures. Management confirmed that this will be completed within 2019/20.</p>	<p>We will complete this review by the end of 2019/20.</p> <p><b>Responsible officer:</b> Nigel Gregory</p> <p><b>Implementation date:</b> March 2020</p>



## 2. Audit committee handbook

Initial rating	Issue & recommendation	Management comments
<p><b>Grade 2</b></p>	<p><b>Observation</b></p> <p>The Scottish Government issued an update to the Audit Committee Handbook in April 2018. This included a number of minor amendments as well as one major addition that impacts on the responsibilities of the Audit Committee.</p> <p>We confirmed that management are already aware of this guidance and plan to discuss it with the Audit and Risk Assurance Committee in September 2018.</p> <p><b>Recommendation</b></p> <p>SHR should ensure that, following review of the new Handbook, any necessary changes are addressed in a timely manner to ensure compliance.</p>	<p>ARAC is due to consider the revised SG Audit Committee Handbook when it meets in September. We will then take account of any changes ARAC proposes to make to its own Terms of Reference when ARAC reviews the Terms at its December meeting.</p> <p><b>Due date:</b> December 2018</p>
Current status	Audit update	Management response
<p><b>Complete</b></p>	<p>We can confirm that ARAC considered the revised SG Audit Committee Handbook when it met in September 2018.</p> <p>ARAC reviewed its Terms of Reference when it met in December 2018, taking cognisance of the new Handbook.</p>	<p>N/A</p>

