Registers of Scotland

Report on the 2006-07 Audit

6 August 2007

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Executive Summary

Introduction

We have audited the financial statements of the Registers of Scotland (ROS) for 2006-07 and examined aspects of RoS's performance and governance arrangements. This report sets out our key findings.

Financial Statements

We have given an unqualified opinion on the financial statements of RoS for 2006-07 and on the regularity of transactions undertaken during the financial year. During the year, RoS turnover increased from £78.684 million to £87.703 million (an increase of 11%) whilst operating expenditure increased from £55.575 million to £59.412 million (an increase of 7%). ROS operating surplus also rose from £24.503 million to £29.221million and this enabled the Agency to make an increased dividend payment of £7.152 million (£5.442 million 2005-06) to the Scottish Executive.

Staff costs account for 66% of RoS expenditure with depreciation (6%) and other operating expenditure accounting for the remainder.

Capital expenditure for 2006-07 was £9.242 million, representing an underspend of £2.986 million (32%) against the budget of £12.261 million. There is scope for RoS to review its arrangements for capital budgeting and monitoring and agreeing timescales as part of its partnership arrangement with BT.

The financial statements record a significant accumulated income and expenditure reserves position of £115.964 million at 31 March 2007. The Agency has plans in place to utilise £113m of these reserves. RoS should continue to keep its reserves position and investment plans under review to ensure reserves remain sufficient to meet future demands but are not built up unnecessarily.

RoS's draft financial statements were presented for audit on 4 June 2007, in accordance with the agreed deadline for submission. The accounts and supporting working papers were of a good standard and, as a result, few adjustments were required to be processed following our audit.

Governance

We found that RoS's governance arrangements operated well and within a generally sound control environment. RoS generally complies with the good practice guidance in relation to governance, as outlined in the Scottish Public Finance Manual (SPFM), in so far as it is relevant to its role. We note, in particular, that the Agency has taken action to ensure membership of its audit committee will comply with the requirements of the SPFM for the 2007-08 financial year.

Our review of internal audit arrangements found that RoS's internal auditors complied with the requirements of the Government Internal Audit Manual, and we were able to place reliance on their work.

Performance

We carried out an overview of RoS's arrangements in relation to the duty to deliver best value and efficiency in its operations. Our review found that RoS does not yet have a formal approach in place to demonstrate that it achieves best value and efficiency in its operations.

During the year, RoS achieved all of its performance targets set by Scottish Ministers. RoS financial objective is to return 6% a year on average net assets employed over the first three years of trading fund status and then maintain this on a rolling three-year basis. The year to 31 March 2007 was the eleventh year of trading fund status. Return on average net assets (after deduction of allowable provisions) for the three years to 31 March 2007 amounted to 26% (calculated before allowing for interest receivable). A summary of the Agency's performance against Ministerial targets is included at Appendix C.

The Way Forward

Our findings and recommendations are summarised in an Action Plan (Appendix A) that accompanies this report. The Action Plan has been agreed with management and incorporates the management response to audit recommendations.

The report includes some specific recommendations to strengthen internal controls. It is the responsibility of RoS and its Accountable Officer to determine the extent of the internal control system appropriate to its operations.

Acknowledgements

We would like to take this opportunity to thank the staff who have been involved in the audit for their assistance and co-operation.

This report is part of a continuing dialogue between RoS and Grant Thornton UK LLP and is not, therefore, intended to cover every matter which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in RoS's systems and work practices.

The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place upon it. The report will be submitted to the Auditor General for Scotland and will be published by him on his website at www.audit-scotland.gov.uk.

Grant Thornton UK LLP
6 August 2007

Financial Statements

Our Responsibilities

We audit the financial statements 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, on the state of affairs of RoS as at 31 March 2007 and of its net expenditure, recognised gains and losses and cash flows for the year then ended;
- they, and the part of the Remuneration Report to be audited, have been properly prepared in accordance with the Government Financial Reporting Manual (FReM) and directions made thereunder by the Scottish Ministers; and
- in all material respects the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

We also review the Statement on Internal Control by:

- considering compliance with Scottish Executive guidance;
- considering the adequacy of the process put in place by the Accountable Officer to obtain assurances on systems of internal control; and
- assessing whether disclosures in the Statement are consistent with the information obtained from our normal audit work.

Overall Conclusion

We have given an unqualified opinion on the financial statements of RoS for the 2006-07 financial statements. We are able to conclude that the financial statements of RoS give a true and fair view of the financial position for the period from 1 April 2006 to 31 March 2007 and that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and relevant guidance.

Standard of accounts and supporting papers

RoS's draft financial statements were presented for audit on 4 June 2007. The accounts and supporting working papers were of a high standard and, as a result, few adjustments were required to be processed following our audit.

A small number of presentational amendments to the draft financial statements were recommended and accepted by management during the audit process. These changes are reflected in the final draft financial statements presented to the audit committee.

Financial Performance

During the year, RoS' turnover increased from £78.684 million to £87.703million (an increase of 11%) whilst operating expenditure increased from £55.575 million to £59.412 million (an increase of 7%). RoS operating surplus also rose from £24.503 million to £29.221 million and this enabled the Agency to make an increased dividend payment of £7.152 million (£5.442 million 2005-06) to the Scottish Executive. The Agency's 3-year return on net capital employed for 2006-07 was 26%.

Staff costs accounts for 66% of RoS' expenditure with depreciation (6%) and other operating expenditure accounting for the remainder.

Capital expenditure for 2006-07 was £9.242 million, representing an underspend of £2.986 million (32%) against the budget of £12.261 million. The underspend has occurred due to slippage in the Back Office Systems Initiative (BOSI), Public Facing Systems Initiative (PFSI) and other Business Change projects. RoS will carry forward the work planned for 2006-07 into the 2007-08 financial year.

Capital commitments for 2007-08 are £15.106 million, reflecting the continued investment in IT systems as part the partnership arrangement with BT. RoS should review its arrangements for capital budgeting and monitoring and agreeing timescales as part of its partnership arrangement with BT.

Refer Action Plan Point 1

Reserves

The financial statements record an accumulated income and expenditure reserves position of £115.964 million at 31 March 2007. The scale of the RoS reserve balance reflects the large surpluses achieved over a number of years. Holding a large reserve balance allows RoS adequately to fund projects for which it does not receive funding, however there is a risk that accumulated reserves can be clawed back (by the Scottish Executive) if RoS cannot demonstrate how it intends to use them.

During 2006-07, RoS developed a reserves policy which set out the aims and objectives for its reserves together with plans to earmark reserves for specific purposes. These include:

- costs of increasing the coverage of the Land Register;
- the marginal costs of implementing feudal abolition in the Land Register;
- further investments in IT system;
- future accommodation costs; and
- the ability to cover potential future indemnity claims.

The cost of these plans is estimated to be approximately £113 million. RoS should keep its reserves position and investment plans under review to ensure accumulated reserves are not built up unnecessarily but are sufficient to meet future demands. RoS should consider the implications of the reduction in its prices from 2007-08 onwards and whether this will reduce future reserve balances below that which has been earmarked.

Refer Action Plan Point 2

Statement on Internal Control

The Statement on Internal Control sets out the arrangements established and operated for risk identification and management, proposed future development of arrangements, and review of effectiveness of the system of internal control.

We are satisfied that the Statement complies with Scottish Executive guidance, that the process put in place by the Accountable Officer to obtain assurances on systems of internal control is adequate, and that the contents of the Statement are consistent with the information obtained from our normal audit work.

ISA 260: Communication of Audit Matters to Those Charged with Governance

Our responsibilities in relation to the communication of audit matters to those charged with governance are covered in the International Standard on Auditing 260 and the matters we are reporting against the requirements of the Standard are contained in Appendix B. In this context, there are no unadjusted errors which we are required to report in accordance with the Standard.

The 2006-07 financial statements record a provision of £407,000 for indemnity claims. RoS does not currently include indemnity claims classified as 'informal', i.e is where there is no formal claim, when calculating its indemnity provision and this approach is not compliant with Financial Reporting Standard 12. Our audit confirmed that RoS's indemnity provision is not materially mis-stated, however, we have recommended that RoS review its methodology for calculating indemnity liabilities for the 2007-08 financial statements.

Refer Action Plan Point 3

Governance

Introduction

Corporate governance is the system by which an organisation directs and controls its functions and relates to its stakeholders, and incorporates the way in which an organisation manages its business, determines strategy and objectives and goes about achieving those objectives. It is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation. Three fundamental principles of corporate governance apply equally to all public sector bodies - openness, integrity and accountability.

As part of our 2006-07 audit, we assessed the adequacy of RoS's governance arrangements against good practice standards for the public sector. We examined:

- the structures and processes for decision making;
- risk management and systems of internal control;
- arrangements for the prevention and detection of fraud and irregularities;
- standards of conduct, integrity and openness; and
- reporting arrangements and monitoring of RoS's overall financial position.

Corporate governance arrangements

We found that RoS's corporate governance arrangements operated well and within a generally sound control environment. We identified some areas where further work is required to meet fully the requirements of the Scottish Public Finance Manual (SPFM) and other aspects of good practice in corporate governance, in particular:

- RoS does not currently make use of risk registers at an operational level; and
- membership of the RoS audit committee does not meet the requirements of the SPFM, although the Agency is planning to restructure this committee in 2007-08 to address this matter.

RoS has agreed to review its risk management arrangements during the 2007-08 financial year and has taken action to ensure membership of its audit committee will comply with the requirements of the SPFM.

Key controls

We reviewed RoS's systems of internal control in relation to key financial systems as part of our interim audit review. We found that RoS's systems of internal controls are generally operating effectively.

Internal audit

RoS appointed Deloitte as its internal auditor for the year ending 31 March 2007. Our review of the internal audit function confirms that they comply with Government Internal Audit Standards and adopt a risk based approach in planning audit work. As a result we have placed reliance on the work of internal audit for the purposes of our audit.

Performance

Introduction

Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our annual audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.

Best value

The Chief Executive has a duty to ensure public resources are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources. A review of best value arrangements for RoS was issued in 2005-06, which reported that RoS is generally complying the requirements.

RoS does not yet, however, have a formal approach in place to demonstrate that it achieves best value and efficiency in its operations.

Refer Action Plan Point 4

Ministerial Targets

During the year, RoS achieved all of its performance targets set by Scottish Ministers. RoS' financial objective is to return 6% a year on average net assets employed over the first three years of trading fund status and then maintain this on a rolling three-year basis. The year to 31 March 2007 was the eleventh year of trading fund status. Return on average net assets (after deduction of allowable provisions) for the three years to 31 March 2007 amounted to 26% (calculated before allowing for interest receivable).

A summary of RoS's performance against Ministerial Targets for the year ending 31 March 2007 is contained in Appendix C.

Performance against Ministerial targets is not reviewed by internal audit and no assurance statement is given in relation to the accuracy of their calculation and reporting. We note that the Keeper will set his own targets and not the Scottish Ministers from 2007-08.

Refer Action Plan Point 5

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6 August 2007

Appendix A – Action Plan

No	Finding	Risk	Recommendation	Management Response	Implementation date
Financial Statements					
1	Capital expenditure for 2006-07 was £9.242 million representing an underspend of £2.986 million (32%) against the budget of £12.261 million. The underspend has occurred due to slippage in the BOSI, PFSI and Business Change projects.	Medium	RoS should review its arrangements for capital budgeting and monitoring and agreeing timescales as part of its partnership arrangement with BT.	The arrangements for budgeting partnership costs are managed and reviewed on an ongoing basis by senior managers. Many projects have to be introduced sequentially and cannot therefore be brought forward to take up slippage in the programme. We intend to review current arrangements for programme management and budget control.	Ongoing 31 March 2008
2	The financial statements record an accumulated income and expenditure reserves position of £115.964 million at 31 March 2007. The Agency has plans in place to utilise £113m of these reserves.	Medium	RoS should keep its reserves position and investment plans under review to ensure reserves are sufficient to meet future demands but are not built up unnecessarily. RoS should consider the implications of the reduction in its prices from 2007-08 onwards and whether this will reduce future reserve balances below that which has been earmarked.	RoS reviews its reserves position and investment plans at least once a year and will continue to do so. As part of the Fee Review the impact of the reduction was estimated and the actual effect is monitored monthly. Any updated thinking about the impact will be incorporated into RoS's future plans.	Ongoing

No	Finding	Risk	Recommendation	Management Response	Implementation date
3	RoS provide for the estimated value of indemnity claims as assessed by its legal department but has not provided for claims classified as 'informal'. We did not regard this approach as compliant with FRS 12.	Medium	RoS review its methodology for calculating indemnity liabilities for the 2007-08 financial statements.	The methodology adopted was that recommended by the previous auditors and accepted by RoS as being appropriate and compliant with FRS 12. We will review	For 2007-08 year-end
Performance					
4	RoS does not yet, have a formal approach in place to demonstrate that it achieves best value and efficiency in its operations.	Medium	RoS should formalise its approach to achieving best value and efficiency in its operations.	Historically RoS has performed well against the Best Value criteria but has taken the view that it is preferable to report via its existing reporting channels. We have commenced a new assessment, using the latest self-assessment questionnaire, of our operations against the guidelines published in 2006-07. It is expected however that much of the ongoing reporting will continue to be through existing channels rather than creating a new Best Value one.	31st December 2007
5	Performance against Ministerial targets is not reviewed by internal audit and no assurance statement is given in relation to the accuracy of their calculation and reporting.	Low	RoS should consider the need to obtain independent assurance on the accuracy of data used to measure and report its performance against set targets.	In the past the targets have been partly looked at by the external auditors, but not comprehensively They are however, in part at least, based on systems that have already been subject to audit. They have previously only been looked at by internal audit where it was considered to be a complex or high-risk area – although wider management information reporting has been subject to internal audit. We will give consideration to how best we might engage with internal audit in respect of the targets.	30 November 2007

Appendix B - Communication of audit matters to those charged with governance

ISA 260 – Communication of audit matters to those charged with governance

Under ISA 260, we are required to consider matters of governance interest that arise from the audit of the financial statements and communicate them with those charged with governance. The areas considered are as follows:

a) Relationships that may bear on the Grant Thornton UK LLP's independence and the integrity and objectivity of the audit engagement lead and audit staff;

b) The overall approach to the audit including any limitations thereon, or any additional requirements;

c) The selection of, or changes in, significant accounting policies and practices that have, or could have a material effect on the entity's financial statements;

d) The potential effect on the financial statements of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements;

e) Audit adjustments, whether recorded or not by the entity that have, or could have a material impact on the entity's financial statements; and

f) Those uncorrected misstatements aggregated by the auditor during the audit that were determined by management to be immaterial both individually and in aggregate to the financial statements as a whole.

Key Findings

We summarise our key audit findings in relation to the above areas in the table below:

Ref	Area	Key Messages
A	Independence	We are able to confirm our independence and objectivity as auditors and note the following: • we are independently appointed by Audit Scotland; • we comply with the Auditing Practices Board's Ethical Standards; and • RSM Robson Rhodes LLP merged with Grant Thornton UK LLP with effect from 1 July 2007. Grant Thornton has undertaken non-audit work for ROS with a value of £16,000 during the 2006-07 financial year. This work was contracted for and performed prior to the merger. We have, therefore, concluded that no conflict of interest exists which would mitigate our independence as auditors for the 2006-07 accounts.
B	Approach to the audit	Our approach to the audit was set out in our 2006-07 audit plan. We have planned our audit in accordance with International Auditing Standards and the Code. Other key factors to highlight include: • we consider the materiality of items in the financial statements both in determining the approach to audit them and in determining the impact of any errors; • we have been able to place appropriate reliance on the key accounting systems operating at ROS for final accounts audit purposes only; and • we have been able to place reliance on the work of internal audit in respect of the key accounting systems.
C	Accounting policies and practices	We consider that ROS has adopted appropriate accounting policies in the areas covered by our testing. Accounting policies adopted were in accordance with the Government Financial Reporting Manual (FReM).
D	Material risks and exposures	ROS has considered and confirmed that it has no material risks and exposures which should be reflected in the financial statements. ROS is asked to confirm this in the Letter of Representation

Ref	Area	Key Messages
E	Audit adjustments and unadjusted errors	We identified several minor disclosure amendments and reclassifications to improve the presentation of the accounts. ROS has agreed to adjust the accounts.

Accounting issues

Cash Flow Statement

The presentation of the Cash Flow Statement was amended to reflect better the template contained within the Government Financial Reporting Manual.

Indemnity provision

The 2006-07 financial statements record a provision of £407,000 for indemnity claims. Indemnity claims can be made by third parties against the Keeper of the Registers of Scotland under the Land Registration Act (Scotland) Act 1979. The Act sets out the circumstances where third parties can make a claim against the Keeper.

The Agency's legal department handles all claims for indemnity, maintains a list of all claims and estimates the likely value for each claim. All claims are investigated to confirm liability under the 1979 Act.

RoS only provide for the estimated value of indemnity claims assessed by its legal department as "received from solicitor" (i.e. claims where a solicitor acting on behalf of the third party has sent a claim with a stated value to RoS). All other claims are classed as "informal" and not provided for.

Financial Reporting Standard 12, (*Provisions, Contingent Liabilities and Contingent Asserts*) indicates that a provision should be recognised where:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that a transfer of economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

Our audit indicated that RoS may not fully comply with the requirements of FRS12 as indemnity claims it classifies as 'informal' may not be sufficiently provided for. We have not requested an adjustment to the accounts for 2006-07 as further audit work identified that the likely payouts for these claims would not alter the existing provision.

We have recommended that RoS review its approach to estimating its liabilities in relation to indemnity claims for the 2007-08 financial statements.

Summary of accounting adjustments

	Income & Expenditure account		Balance Sheet	
	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Adjustments affecting reported results				
None				

Summary of unadjusted audit differences

	Income & Expenditure account		Balance Sheet	
	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Adjustments affecting reported results				
None				

Grant Thornton UK LLP

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Appendix C - Performance against Ministerial Targets

Target	Performance 2006-07	Achieved
Sasine turnaround times To average no more than 20 working days over the year as a whole.	17.8 days	✓
Dealings with whole turnaround times To average no more than 30 working days over the year as a whole.	21.8 days	✓
Domestic first registration turnaround times 1. To average no more than 100 working days over the year as a whole. 2. To eliminate all pre-July 2002 casework.	(1) 69.6 days (2) Achieved	✓
Registration Accuracy To achieve a registration accuracy rate of at least 98% for applications despatched during the previous 12 months.	98.7%	✓
Return on Capital Employed To achieve 15% over three year period.	26.0%	✓
Standard Production Cost Index Limit increase to 1% for the three years ending 31 March 2007.	0.3%	✓
Customer service To continue to operate to Charter Mark standards including achieving a 98% rating for overall customer care in the annual customer satisfaction survey of solicitors.	99%	✓
Customer service Processing 98% of all customer enquiries in compliance with the Agency's published response standards.	99%	✓