



# Scottish Housing Regulator

2019/20 Annual Audit Report to the Board and the Auditor General for Scotland

October 2020



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# Key messages



## Annual report and accounts audit

The Scottish Housing Regulator's annual report and accounts for the year ended 31 March 2020 were approved by the Board on 8 October 2020.

We have reported 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 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 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 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 SHR's accounting and internal control systems throughout the period or as a result of remote working during the COVID-19 pandemic.



### Financial sustainability

- Overall, SHR has effective arrangements in place for financial planning and monitoring.
- The Board has approved indicative revenue and capital budgets for 2020/21. However, the achievement of a balanced position is dependent on receiving additional revenue funding of £200,000 and capital funding of £200,000. A strong business case has been made to Scottish Government for this revenue funding, however, there has been no indication of the timeline for a decision. Without this funding, SHR is projecting significant overspends in 2020/21. SHR received confirmation in August 2020 that capital funding of £200,000 will be provided for 2020/21.
- In response to the COVID-19 pandemic, SHR has made immediate and short-term changes to their priorities and regulatory approach. A consultation exercise has been carried out to adjust elements of the regulatory framework to reflect this. All but the most critical regulatory engagement has been postponed allowing resource to be reallocated to managing emerging risks. Operating and Corporate plans are being revised to reflect the new environment and it is vital that management continue to closely monitor and manage the challenging financial position.
- Staff cost continues to be a significant pressure. SHR deem that a balanced financial position in 2020/21 is only achievable on the assumption that they operate with a vacancy rate of around 8%. At a full staffing compliment, SHR project an overspend of £295,000. Work on developing a Workforce Strategy has been put on hold given the recent shifts in priorities. As outlined in the updated Operating Plan, management have committed to developing the Workforce Strategy by March 2021. Given the significant level of financial pressure staff cost 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 2019/20. Our work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK) and Ethical Standards.

Azets  
October 2020

# Introduction

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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 2019/20.

We carried out our audit in accordance with Audit Scotland’s Code of Audit Practice. 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”.

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## Introduction

1. This report summarises the findings from our 2019/20 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 2019/20 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 complied with the Financial Reporting Council's (FRC) Ethical Standards. 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 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 any member of your audit team.

## Openness and transparency

11. This report will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).



# Annual report and accounts

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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 2019/20 annual report and accounts.

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## 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 2020 were considered by the Audit and Risk Assurance Committee on 8 September 2020 and approved by SHR's Board on 8 October 2020. We reported 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

12. The annual report and accounts for the year ended 31 March 2020 were considered by the Audit and Risk Committee on 8 September 2020 and approved by SHR's Board on 8 October 2020. We report within our independent auditor's report:

- An unqualified opinion on the financial statements;
- An unqualified opinion on regularity; and
- 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.

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 2020 deadline.

### Our assessment of risks of material misstatement

16. The assessed risks of material misstatement described in the table below 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 below.

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

### 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*.

*Noted in the 2019/20 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.

### 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.

*Noted in the 2019/20 External Audit Plan*

18. At the planning stage of our audit, we reported that we would rebut the risk of revenue recognition for funding received from the Scottish Government due to a lack of incentive and opportunity to manipulate transactions. SHR does not undertake any income generating activity and funding from the Scottish Government is their only source of income. Our assessment of this risk has been reviewed throughout the audit and our conclusion to rebut this risk has remained appropriate.

### 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.

*Noted in the 2019/20 External Audit Plan*

19. Whilst we did not suspect incidences of material fraud or 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 financial statements. 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.

### Update to our initial risk assessment

20. Planning is a continuous process and our audit plans are updated during the course of our audit to take account of developments as they arise. We have specifically updated our risk assessment and audit plan in light of COVID-19. We recognised this as a key audit risk<sup>1</sup>.

<sup>1</sup> A key audit risk is one which may result in a material misstatement to the financial statements or

significantly impact on our audit judgements and conclusions on the wider scope dimensions..

## COVID-19

The COVID-19 pandemic is presenting unprecedented challenges to the operation, financial management and governance of organisations, including public sector bodies. Core areas of service delivery have been suspended or substantially reduced, systems and processes have been amended to support remote working, arrangements for governance, decision making and performance management have been adapted, and many organisations are forecasting large operating deficits due to loss of income and/ or additional cost pressures. It is uncertain how long these challenges will persist.

The implications of these risks and uncertainties are under consideration by SHR and the Scottish Government. We continue to monitor government and relevant announcements as they pertain to the audit and have adapted our audit approach as required.

21. In response to this risk we identified potential areas where there was the risk of material misstatement to the financial statements and/or our audit opinion. These areas included:
- Content of the annual report and accounts
  - Access to audit evidence
  - Timescales/administrative processes

### Content of the annual report and accounts

22. In May 2020, HM Treasury issued an addendum to the Government Financial Reporting Manual (FReM) which covered the following:
- The addendum permits, but does not require, bodies to omit or reduce the performance analysis section from the Performance Report. Where relevant performance information has already been published elsewhere, bodies are encouraged to refer to the relevant publication.
  - Where unaudited information otherwise required to be included in the Accountability Report is already published elsewhere, bodies are permitted to refer to the relevant publication rather than including the

information in their Accountability Report.

23. SHR has chosen not to apply the addendum to the FReM and has produced a complete annual report for their 2019/20 accounts.

### Access to audit evidence

24. Our audit this year has been carried out remotely. As a consequence, we identified a risk that access to and provision of sufficient, appropriate audit evidence in support of our audit opinion may be impacted by the inherently challenging nature of carrying out our audit remotely.
25. We have employed a greater use of technology to examine evidence, but only where we have assessed both the sufficiency and appropriateness of the audit evidence produced.
26. For our expenditure testing, SHR could not provide sufficient audit evidence for six sample items as this information is either held within the office or held by Scottish Government. We continued to liaise with management up until the point of signing, however these pieces of evidence could not be accessed and provided. Given the size and nature of the sample items, we are satisfied that

the testing completed still provides a reasonable basis for our conclusion and do not deem this to be material to our proposed audit opinion or timing thereof.

27. SHR took action to digitise their records during 2019/20, ensuring that all supporting documentation is held electronically. We are satisfied that processes have been appropriately updated in response and deem this to be a legacy issue.
28. For all other aspects of our audit we have been provided with sufficient evidence to complete the audit in line with our responsibilities. There were no issues noted with the reliability or appropriateness of evidence provided.

#### Timescales/Administrative processes

29. In Scotland, the administrative deadline for the submission of audited accounts of central government bodies remained as 31 October 2020. However, given the disruption caused by COVID-19 the decision was taken to postpone the audit by two months.
30. The Board approved the annual report and accounts on 8 October 2020 and arrangements are in place to ensure these are submitted to the Scottish Government and Auditor General for Scotland by the 31 October 2020 deadline.
31. We have been working closely with management throughout the audit to put us in the best position to ensure this timetable is adhered to and have successfully done so.

#### An overview of the scope of our audit

32. The scope of our audit was detailed in our External Audit Plan, which was

presented to the Audit and Risk Assurance Committee in March 2020. 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 SHR. 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.

33. 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.
34. 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 management team. In performing our work we have applied the concept of materiality, which is explained earlier in this report.

#### Our application of materiality

35. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement. We review our assessment of materiality throughout the audit.

36. Performance materiality is the working level of materiality used throughout the audit. We use performance materiality to determine the nature, timing and extent of audit procedures carried out. We perform audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we perform a greater level of testing on the areas deemed to be at significant risk of material misstatement.

37. Performance materiality is set at a value less than overall materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of the uncorrected and undetected misstatements exceed overall materiality.

38. Our initial assessment of materiality for the financial statements was £76,000 and it remained at this level throughout our audit. This equates to approximately 1.8% of SHR's 2019/20 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. We consider our updated assessment has remained appropriate throughout our audit.

	Materiality £'000
<b>Overall materiality:</b> Our assessment is based on approximately 1.8% of SHR's net operating cost in 2019/20. Achieving a breakeven position is a key target for SHR and one of the principal considerations for the users of the financial statements when assessing financial performance	76
<b>Performance materiality:</b> Using our professional judgement we have calculated performance materiality at approximately 75% of overall materiality.	57

39. We noted within our External Audit Plan that we would report on all audit differences in excess of 5% of the overall materiality figure, as well as differences below that threshold which, in our view, warranted reporting on qualitative grounds. We also report on disclosure matters that we identify when assessing the overall presentation of the financial statements.

## Audit differences

40. We are pleased to report that there were no material adjustments to the financial statements. We identified some disclosure and presentational adjustments during our audit. These have been reflected in the final set of financial statements.

41. We identified one unadjusted audit difference which was not considered material to the financial statements, as detailed at Appendix 3. This relates to the reversal of an adjustment made by SHR to the accumulated depreciation of

server assets in response to the extension of the economic useful life.

## Representations

42. We have requested that a signed representation letter be presented to us at the date of signing the annual report and accounts. This letter is to be signed by the Accountable Officer on behalf of the Board.

## Other matters identified during our audit

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

### Other information in the annual report and accounts

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

### The performance report

45. 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.

46. 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

47. 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), a remuneration and staff report, and a parliamentary accountability report.

48. 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.

49. 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.

50. Overall, the disclosures in the governance statement are consistent with this and internal audit's conclusions for 2019/20. We have considered this further in section 4.

### Internal Audit

51. 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

52. 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.

### Looking forward – IFRS 16 Leases

53. IFRS 16 Leases will be effective from 1 April 2021. 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.

54. 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.
55. 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

56. 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 report and 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 are satisfied with the appropriateness of other accounting estimates and judgements used in the preparation of the financial statements.
The appropriateness of the going concern assumption	We have reviewed the detailed financial forecasts for 2020/21. 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 financial statements 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 report and accounts.
The extent to which the financial statements 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 annual report or material inconsistencies with the accounts.	The annual report contains no material misstatements or inconsistencies with the financial statements.
Any significant annual report and 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 disclosures as referred to previously.

Qualitative aspect considered	Audit conclusion
Disagreement over any accounting treatment or annual report and 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 a number of invoices in relation to expenditure items during our fieldwork. This was outwith SHR's control and was due either to a delay in receiving information from the Scottish Government or as a consequence of the SHR office being closed during the Covid-19 pandemic.

## Wider scope

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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.
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## Wider scope conclusions

### Governance statement



We are satisfied that the Governance Statement has been prepared in accordance 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 SHR's accounting and internal control systems throughout the year or as a result of remote working during the COVID-19 pandemic.

### Financial sustainability



SHR has effective arrangements in place for short and medium term (3 year) financial planning. The Board has approved indicative revenue and capital budgets for 2020/21. However, the achievement of a balanced position is dependent on receiving additional revenue funding of £200,000 and capital funding of £200,000. A strong business case has been made to Scottish

Government for this revenue funding, however, there has been no indication of the timeline for a decision. Without this funding, SHR is projecting significant overspends in 2020/21. SHR received confirmation in August 2020 that capital funding of £200,000 will be provided for 2020/21.

In response to the COVID-19 pandemic, SHR has made immediate and short-term changes to their priorities and regulatory approach. A consultation exercise has been carried out to adjust elements of the regulatory framework to reflect this. All but the most critical regulatory engagement has been postponed allowing resource to be reallocated to managing emerging risks. Operating and Corporate plans are being revised in response and it is vital that management continue to closely monitor and manage the challenging financial position.

Staff costs continue to be a significant pressure. SHR deem that a balanced financial position in 2020/21 is only achievable on the assumption that they operate with a vacancy rate of around 8%. At a full staffing complement, SHR project an overspend of £295,000. Work on developing a Workforce Strategy has been put on hold given the recent shifts in priorities. As outlined in the updated Operating Plan, management have committed to developing the Workforce Strategy by March 2021. Given the significant level of financial pressure staff cost 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

57. Our approach to the wider scope audit (as set out in our 2019/20 External Audit Plan) builds upon our understanding of SHR which we developed from previous years, along with discussions with management and review of minutes and key strategy documents.

58. During our audit we also considered the following risk areas as they relate to SHR:

- EU withdrawal
- Fraud and corruption in respect of the procurement function

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

### Impact of EU withdrawal

As reported in our 2018/19 Annual Audit Report, we deemed SHR to be well prepared for leaving the EU and they were able to demonstrate consideration of the key factors. This included a review of the workforce, relevant legislation and current dealings with the EU. There has been no significant change to SHR's risk assessment in 2019/20.

SHR has continued to work with their regulated sector to explore the risks arising from leaving the EU and ensure they are prepared to manage and mitigate these.

### Fraud and corruption in respect of the procurement function

SHR undertakes a low volume and value of procurement activity, with the majority of their budget comprising staff costs and facilities. Where procurement activity is completed, SHR utilise Scottish Government systems which are in line with best practice and include features aimed at countering fraud, such as enforced segregation of duties.

The risk of fraud and corruption in respect of SHR's procurement function is deemed to be low.



## Governance statement

**Our audit opinion considers whether the Governance Statement has been prepared in accordance with directions made by Scottish Ministers and is consistent with the financial statements.**

60. We are satisfied that the Governance Statement for the year to 31 March 2020 is consistent with the financial statements and has been prepared in accordance with directions made by Scottish Ministers.

61. The Accountable Officer has confirmed that in his opinion, the control arrangements are appropriate and

effective, and no significant issues have been identified.

62. Overall, the disclosures in the governance statement are consistent with this and internal audit's conclusions for 2019/20.

### **Governance arrangements during COVID-19**

63. With national lockdown announced on 23 March 2020, all SHR activity moved to being delivered remotely and they have continued to operate throughout the period.
64. Governance arrangements continued as normally with Board, ARAC and management team meetings being held remotely. The management team and Board are meeting more frequently than normal to oversee SHR's response.
65. The 2020/21 Operating Plan has been prepared for the March Board meeting; however, it was not brought forward for approval given the early impact of the pandemic. It was agreed that the plan would be considered by the Board later in the year once this had been updated to reflect shifts in priorities and the impact of recent events. The updated Operating Plan and restated three-year Corporate Plan were approved by the Board in August 2020.

### **Systems of internal controls**

66. We have evaluated SHR's key financial systems and internal financial controls to determine whether they are adequate to prevent material misstatement in the annual accounts. Our approach has included documenting key internal financial controls and performing walkthroughs to confirm they are operating as intended.

67. We did not identify any material weakness in SHR's accounting and internal control system.

68. SHR use and rely upon Scottish Government core financial systems to carry out accounting, expenditure and payroll functions. Scottish Government internal auditors have provided assurance that, with the exception of payroll, the Scottish Government's main systems of internal control operated effectively during 2019/20.

69. Issues were identified with regards to the payroll function and Scottish Government have developed an action plan to address these. We have completed sufficient substantive testing to gain assurance that payroll costs are free from material misstatement. SHR receive additional statements of assurance from the Scottish Government and we are satisfied that these have been appropriately reflected within the Governance Statement.

### **Prevention and detection of fraud and irregularity**

70. Our audit was planned to provide a reasonable expectation of detecting material misstatement in the financial statements resulting from fraud and irregularity. We found SHR's arrangements for the prevention and detection of fraud and other irregularities to be adequate and appropriate.
71. SHR has an anti-fraud policy and response plan, an anti-bribery policy and a whistleblowing policy in place to support the timely prevention and detection of fraud and irregularity. All policies are made available to staff through the intranet.



## 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

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

### Financial sustainability

SHR is forecasting a breakeven position in 2019/20, which has largely been achieved through delays to the recruitment programme. Awarding pay increases and meeting additional employer pension contributions has continued to be a significant challenge for SHR, with staff costs accounting for 84% of the 2019/20 budget. As reported in our 2018/19 Annual Audit Report, at a full staffing compliment SHR will likely face potentially significant overspends in 2020/21 and beyond if a flat cash allocation is received.

Management has considered their staffing requirements under the new Regulatory framework (introduced 1 April 2019) and is working towards developing a Workforce Strategy. Robust financial and operational planning is required to ensure that sufficient resource is available to support service delivery and ensure this remains financially sustainable.

*As noted in the 2019/20 External Audit Plan*

74. SHR achieved a breakeven position in 2019/20 against their revenue budget of £4.192 million and capital budget of £200,000. SHR received an additional in-year budget allocation of £107,000 to offset additional expenditure of £140,000 on employee pension costs. Around 75% of revenue costs were staff costs with the next biggest area of spend being IT equipment and support (10%).
75. We confirmed in 2018/19 that SHR has a medium-term financial plan in place which is aligned to the Corporate Plan. Work is on-going however to update the 2020/21 Operating Plan to reflect the impact of COVID-19. Medium term financial projections are also still to be updated as a result. Our work and conclusions on the financial and operational planning for 2020/21 onwards is set out below and notes the ongoing challenges SHR continues to face.



## Indicative 2020/21 budgets

76. 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 to achieve a balanced financial plan and to remain with the annual allocation.
77. SHR has been allocated a cash revenue budget of £4.085million in 2020/21 and a non-cash allocation of £219,000 to cover depreciation and amortisation of non-current assets. This represents a reduction of £107,000 from their 2019/20 revenue allocation.
78. SHR had made a strong business case to the Scottish Government for additional funding as allocations are not deemed sufficient to support financial sustainability. The Scottish Government advised in March that they had designated SHR as "an area of known pressure". As a result, they may increase SHR's 2020/21 revenue funding by up to £200,000 should funding become available during the year. Scottish Government have not given any indication of the timescale for a decision.
79. Assuming that £200,000 is received as an in-year funding allocation, SHR have prepared a balanced budget, as approved by the Board in March 2020. However, this still represents a challenging budget position. Management have ensured that Scottish Government officials are fully aware of the position and the consequences if funding is not provided.

## Staffing costs

80. Staff costs continue to be a significant area of pressure in the 2020/21 budget. To achieve a balanced budget, SHR would require a vacancy rate of around 8% (i.e. between 4 and 5 staff members for the full year).
81. Before factoring in savings from current staff vacancies and assumptions about staff leaving during the year, SHR projected an overspend of £295,000 (this assumes that they also receive the additional £200,000 of revenue funding). SHR have applied a 3% pay increase for 2020/21 in line with the Scottish Government's agreed pay policy.
82. In our 2018/19 Annual Audit Report we highlighted that further work was required to ensure a robust Workforce Strategy is developed in a timely manner. Management committed to starting this work by December 2019.
83. The management team held a workforce planning workshop in November 2019 to commence the process and it was agreed that the strategy would be developed in the first quarter of 2020/21. However, work has been paused and resource has been refocused on managing the response to the Covid-19 pandemic. Work is on-going to update the Operating Plan and this will outline new timescales for the development of the Workforce Strategy.

## Capital budget

84. SHR have made a business case to the Scottish Government for £200,000 of capital funding for 2020/21. This is required to undertake planned and essential upgrades to the business intelligence system (BIS).
85. The system is hosted in the Scottish Government's data centre with the stipulation that the system is fully

supported such that it meets the necessary cyber security requirements. The current version of the system will start to fall out of support over the coming year and will be disabled if any of the components are no longer supported. This is therefore deemed to be essential work and capital funding is therefore necessary to avoid further overspends in 2020/21.

ongoing to understand the impact this will have on operational plans. It is vital that management continue to closely monitor the financial position throughout the year to manage what is already a challenging budget position.

86. SHR received confirmation in August 2020 that capital funding of £200,000 will be provided for 2020/21.

### Impact of COVID-19

87. In response to the UK and Scottish Government escalating the national response to the COVID-19 pandemic in March 2020, SHR made immediate changes to its regulatory approach and moved their focus to monitoring the impact on social landlords.
88. SHR is a key stakeholder in the newly convened Social Housing Resilience Group and has collected monthly data from social landlords to help understand the scale of the disruption and inform a co-ordinated response. All but the most critical regulatory engagement has been postponed allowing resource to be refocused on the most serious emerging risks and the work of the Social Housing Resilience Group.
89. To support transparency and clarity, SHR has made some short-term amendments to their Regulatory Framework to reflect the current environment. These changes were published for consultation and the outcome was presented to the Board in August 2020. The agreed adjustments to the Regulatory Framework were published on 31 August 2020.
90. The scale of the response to date has reduced SHR's capacity and work is still

# 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 is 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 SHR's affairs as at 31 March 2020 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 2019/20 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;
- the use of the going concern basis of accounting in the preparation of the financial statements is not appropriate;
- SHR has not disclosed in the financial statements any identified material uncertainties that may cast doubt about its ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue;
- 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 auditable part of the Remuneration and Staff Report has been properly 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 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 financial statements and the part of the Remuneration and Staff Report to be audited are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

## 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 Ethical Standards. 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 Azets, SHR, its Board members or 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

The recommendations have been rated to help SHR assess the significance of the issues and prioritise the actions required.

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.

## Follow up of prior year recommendations

Of the four recommendations raised within our 2018/19 annual audit report, we note that one remains in progress and three have been implemented. Details are given below.

### 1. Software licenses

Initial rating	Issue & recommendation	Management comments
<b>Grade 2</b>	<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>
Current status	Update	
<b>Complete</b>	Software licences have been fully disposed of in 2019/20 to reflect that they are no longer in use.	



## 2. Financial Systems – user access controls

Initial rating	Issue & recommendation	Management comments
<p><b>Grade 2</b></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 Nicholson</p> <p><b>Implementation date:</b> August 2019</p>
Current status	Update	
<p><b>Complete</b></p>	<p>User access rights have been reviewed in 2019/20 and will be formally considered on an annual basis. Additionally, SHR’s leaver checklist has been updated to ensure the removal of user access is considered.</p>	

### 3. Workforce Plan

Initial rating	Issue & recommendation	Management comments
<b>Grade 3</b>	<p><b>Issue</b></p> <p>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><b>Risk</b></p> <p>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><b>Recommendation</b></p> <p>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>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><b>Responsible officer:</b></p> <p>Michael Cameron</p> <p><b>Implementation date:</b></p> <p>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>

Current status	Update
<b>In progress</b>	<p>The management team held a workforce planning workshop in November 2019 to commence the development of a strategy. However, work has been paused and resource has been refocused on managing the response to the Covid-19 pandemic.</p> <p><b>Management response</b></p> <p>The Board approved our restated Corporate Plan 2019-2022 and Operating Plan 2020-2021, this sets revised timescales for our Workforce Plan to be developed by the end of March.</p>

#### 4. Capital accounting policies and estimates

Initial rating	Issue & recommendation	Management comments
<p><b>Grade 2</b></p>	<p><b>Issue</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 2019/20 accounts.</p> <p><b>Due Date:</b> March 2019</p>
Current status	Update	
<p><b>Complete</b></p>	<p>Capital accounting policies have been reviewed, updated and approved by ARAC in March 2020.</p>	

## Appendix 3: Unadjusted errors

We identified the following potential adjustment to the financial statements during our audit. We have discussed this with management and agreed that it will not be reflected in the financial statements on the basis of materiality.

Unadjusted difference	Statement of Comprehensive Net Expenditure		Statement of Financial Position	
	DR £'000	CR £'000	DR £'000	CR £'000
Depreciation charge	34			
PPE: Accumulated depreciation				34
<i>Being the reversal of adjustment to accumulated depreciation due to the extension of useful economic life of servers</i>				
<b>Net impact on (income) / expenditure (£'000)</b>	<b>34</b>			



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