



THE SCOTTISH HOUSING REGULATOR

Governance Matters: Payments and benefits  
May 2011

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## Case Studies

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# **Governance Matters – Payments and Benefits**

## **Introduction**

- 1 We previously published a report on Governance Matters which included case studies of problems we had become involved in. The purpose of illustrating these problems was to help registered social landlords (RSLs) to learn from others' experiences and improve their own governance. This second report focuses on the particular area of payments and benefits. A well-governed RSL maintains high ethical standards and its good reputation; an RSL making inappropriate decisions about payments and benefits can put at risk both stakeholders' confidence in the RSL's governance and the good reputation of the sector.

## **Purpose**

- 2 This report offers some practical advice for registered social landlords to assist in understanding and applying our regulatory guidance on Schedule 7 (Part 1 of Schedule 7 to the Housing (Scotland) Act 2001). The case studies illustrate typical breaches and lessons learned so that RSLs can avoid some common pitfalls. And we set out our regulatory expectations of how RSLs should apply our guidance in order to work within the legislation and demonstrate good governance.

## **The legislation**

- 3 Part 1 of Schedule 7 to the Housing (Scotland) Act 2001 restricts what payments and benefits registered social landlords can make to governing body members, employees and their close relatives. We also have regulatory guidance which sets out the implications of the legislation and our regulatory expectations for how RSLs should apply the legislation (SHR12 Guidance on Schedule 7 Control of payments and benefits).
- 4 The Housing (Scotland) Act 2010 does not include equivalent legislation to Schedule 7. So from April 2012 when the new Act is "switched on" there will be no explicit statutory restriction on the payments and benefits which

governing body members and employees can receive. But the Scottish Housing Regulator is required to publish a Regulatory Code of Conduct which will incorporate ethical standards relating to payments and benefits. The Board of the Scottish Housing Regulator will consult with the RSL sector and other stakeholders on its proposed Regulatory Code of Conduct which will take effect from April 2012.

- 5 In the meantime, until 31 March 2012, the current legislation and Schedule 7 will continue to apply and we will continue to regulate RSLs' compliance with the legislation. The advice in this note will be relevant for RSLs now and in the future in achieving high ethical standards and public accountability.

## **Cases**

- 6 We recognise that Schedule 7 can sometimes be complex and can also involve difficult and sometimes sensitive areas of decision-making. The case studies illustrate some of the most frequent mistakes RSLs can make in understanding and applying Schedule 7 to business decisions in their organisations.
- 7 The examples in the case studies are of typical, real-life cases we have dealt with that will be directly applicable to many other RSLs. The Schedule 7 breaches included in the case studies are about:
  - a. *grant of a tenancy to a close relative of a member of the governing body.*
  - b. *employment of a close relative of a governing body member.*
  - c. *agreement to an out-of-court settlement with a former employee.*
  - d. *contract with a business where one of the directors of that business was a close relative of a member of staff.*
  - e. *payment to the senior staff member outwith the contract of employment.*
- 8 In each case study, we have set out what the breach was, our decision and actions in response to the breach, and lessons learned for other RSLs. We have only provided as much information in the case studies as is needed to describe the breach and what happened. We use the term governing body to refer to the management committee or board of management.

## **Our regulatory expectations**

- 9 RSLs should have a policy and procedures on controlling payments and benefits. The policy should outline how the legislation and the Schedule 7 guidance will be applied within the organisation, and to any subsidiary or linked organisations if part of a group structure. And if the RSL has charitable status then its policy also needs to set out how any charitable restrictions will be managed. The RSL's policy should also encompass how it will uphold the spirit of the guidance, to exercise good governance and judgement and maintain high ethical standards of honesty, integrity and probity.
- 10 The procedures should cover the practical, operational aspects of day-to-day actions to implement the organisation's policy, such as the declaration and handling of interests by governing body and staff members, and identify what decisions need to take account of Schedule 7 issues and how that will be done. The procedures should include what action the RSL will take should a breach come to light.
- 11 RSLs should also make sure they have appropriate methods for making governing body members and staff aware of the principles and expectations of maintaining good ethical standards and working within Schedule 7, through induction and ongoing training.
- 12 If an RSL has any doubt about whether it should make a particular payment or grant a benefit it should seek independent legal advice. In doing so it should take care that no involved employees or governing body members are included as part of this process. So for instance if the Chief Executive is the subject of a potential benefit or payment, then it should not be the Chief Executive who seeks legal advice about the payment/benefit.
- 13 We do not replicate here the provisions in the legislation and our published guidance. RSLs should refer to our guidance for detailed explanation of the circumstances that need to be considered in making payments and granting benefits to governing body members and employees. But we do recommend

to RSLs to be mindful of our advice here when interpreting and applying the guidance in real situations.

- 14 RSLs which have charitable status also need to have regard to the restrictions on personal benefits and remuneration for their governing body members as charity trustees.

### **Breaches of Schedule 7**

- 15 Where an RSL has made a payment or benefit which is prohibited by Schedule 7, we call this a breach of Schedule 7. And depending on the nature and circumstances of the breach it can be a material breach or a technical breach.
- 16 A material breach of Schedule 7 would be where an RSL has granted a payment or benefit to a relevant person or relevant business which is not permitted by any of the general or special exceptions.
- 17 A technical breach is where the payment or benefit is permitted by one of the exceptions set out in our guidance but the RSL has not followed the provisions governing the use of the exception and so has committed a technical breach. This is because there are particular processes RSLs must follow in granting benefits or making payments covered by special exceptions. If these are not followed the organisation can still be in breach even though the benefit is technically covered by an exception.
- 18 These processes are to help RSLs show accountability and transparency in granting the benefit/payment. So it is vital that the process is followed; if not, then the RSL will breach the legislation. For instance, if the RSL did not obtain the necessary pre-approval of the governing body before granting a tenancy to a close relative of a governing body or staff member. This is a benefit in terms of the Schedule 7 legislation but it is allowed by special exception 1 provided the let is in accordance with the RSL's allocations policy and the governing body/staff member had no involvement or influence over the allocation process. This needs to be reported to the governing body for its

decision. And the governing body must decide on the use of this special exception, before the allocation offer is made. If the RSL does not seek the governing body's approval before making the allocation then this is a technical breach of Schedule 7. Getting the governing body to approve a decision retrospectively does not remedy the situation – the breach has still occurred.

### **What happens if there is a breach**

19 We expect the RSL to:

- let us know about the breach and the facts and circumstances around it;
- tell us what action it intends to take to deal with the breach itself, for instance, to recover the payment or benefit if that is appropriate; and
- make sure it will comply in future with the legislation and avoid similar breaches, for example by strengthening its Schedule 7 policies and procedures to address the identified weakness that led to the breach or providing refresher training for staff and/or governing body members on Schedule 7.

20 We need to understand the facts of the breach to establish the nature and circumstances of the breach. In terms of the facts we need to know:

- The details of the payment or benefit; for example, the grant of a tenancy, a non-contractual bonus payment, the award of a contract of employment or a commercial contract, etc., including relevant dates of decisions and payments/benefits.
- The positions of the people involved and the nature of any relevant relationships.
- The factors that the RSL's governing body considered in reaching its decision, including its awareness of the Schedule 7 legislation and guidance, its own policies and procedures, and any legal advice.
- Whether all the RSL's other procedures were followed properly apart from the breach (e.g. procuring a contract, open recruitment for a job, normal criteria for tenancy allocation etc.).

- The actions taken by the RSL to make sure that a similar breach does not recur.

21 Having established there has been a breach and the facts of the breach, we need to consider other issues to decide on our response and action, such as:

- The speed and manner of the RSL's response once a breach has been identified.
- The materiality and seriousness of the case.
- The potential to damage the reputation of the sector.
- The RSL's track record on Schedule 7 and associated governance issues.
- Evidence of intent to deceive or mislead and evade Schedule 7.
- The impact of a decision to recover on the beneficiary (e.g. any decision to recover a payment or benefit awarded under a contract which was entered into in good faith may directly affect the recipient rather than the RSL).
- The impact of the RSL's decision, and the possible impact of a decision to recover, on the RSL's financial situation.

22 It is important to state that it is not within our powers as regulator to set aside or approve a breach. A breach has either happened or not and that is determined by the facts of the case. But in considering what action we need to take in response to the breach and what action we require of the RSL, we will take account of the circumstances of the case and the RSL's own actions when it identified the breach.

23 A point to note is that we expect an RSL to take seriously any breach, to take action to put right what caused the breach, and to co-operate with us. On some occasions, where an RSL has been defensive and unco-operative, we have had to engage more intensively with the RSL. What may have started out as a Schedule 7 breach can become a more serious governance problem because the RSL does not give us the confidence that it recognises its responsibilities to put right the breach and to be accountable for ensuring no

governing body or staff members benefit inappropriately from their positions. We must be able to protect the reputation of the RSL sector and safeguard tenants' interests and we expect RSLs to work with us to achieve this.

### **Next steps**

- 24 This note offers some practical advice on considering Schedule 7 issues in RSLs' day-to-day decision-making. It presents an opportunity to share experiences from other RSLs which have dealt with Schedule 7 issues and help your RSL to avoid similar breaches, and ultimately to strengthen and improve governance and ethical standards.
  
- 25 We expect governing body members and staff to consider this practical advice and the lessons learned from the case studies in relation to your own organisations to ensure you are able to work within the current legislation, and, in the future, continue to uphold the high ethical standards and good reputation of the RSL sector.

**The Scottish Housing Regulator**

**May 2011**

## **Schedule 7 Case Studies**

### **Case Study 1: grant of a tenancy to a close relative of a member of the governing body.**

#### **Schedule 7 Breach**

RSL A granted a tenancy to a close relative of a member of the governing body (a relevant person in terms of Schedule 7). The organisation followed its allocations policy for allocating a tenancy to a close relative of a governing body member, but the governing body did not make the decision to approve the allocation until after the allocation was made.

#### **Our decision**

We decided this was a breach of Schedule 7 because:

- The allocation was technically permitted by special exception 1 of the Schedule 7 guidance which allows tenancies to be allocated to close relatives of relevant persons;
- But the RSL did not get governing body approval before the allocation was made, therefore, the RSL breached Schedule 7.

#### **Our actions**

In reviewing the breach and what action we would take we took account of these factors:

- The RSL followed its allocations policy and procedures.
- The relevant persons involved had no influence or involvement in the allocations process.
- There was no evidence of special treatment for members of the governing body or their close relatives.
- But the allocation was not approved by the governing body until after the tenancy had been allocated.

This was a breach of Schedule 7 but we considered it a technical breach – that is, the payment or benefit is permitted by one of the exceptions but the RSL did not

follow the provisions attached to the use of the exception which require the governing body to make the decision to grant the allocation.

In this case, we decided not to direct recovery of the tenancy. We asked the RSL to seek further training on Schedule 7 to ensure it could properly work within the terms of the legislation and the guidance.

### **Lessons learned**

- While the RSL acted appropriately in making the allocation, it is a necessary step for the governing body to first make its decision about the proposed allocation before the tenancy is granted in order to comply with the conditions in special exception 1.
- RSLs should make sure that their policy and procedures follow the requirements of the special exception in order not to cause a breach.

## **Case Study 2: employment of a close relative of a governing body member**

### **Schedule 7 Breach**

RSL B employed a close relative of a governing body member as an interim manager after the RSL's Director had left the organisation.

### **Our decision**

We decided this was a breach of Schedule 7 because:

- There is an explicit prohibition on the close relative of a governing body member being given employment.
- There is no special exception that allows an RSL to employ a close relative of a governing body member.
- The RSL argued that the interim manager was not employed by the RSL, but had been awarded a commercial contract that is allowed by special exception 5. Even if this were the case, it would still have been a breach of the special exception because the RSL had not fulfilled the conditions of the special exception. That is, the RSL could not demonstrate that the relevant business offered better value for money than any alternative; or that the procurement process was fair and accountable; or that the governing body member was not involved in any aspect of the management of the contract.
- And the guidance specifically states that a consultant brought in to carry out the duties that would normally be performed by a paid member of staff would be considered an employee for the purpose of the guidance.

### **Our actions**

In reviewing the breach and what action we would take we took account of these factors:

- This was a serious and material breach of Schedule 7.
- The governing body failed to demonstrate good governance or an understanding of Schedule 7.
- The RSL could not demonstrate that it did not breach Schedule 7, even when arguing that it had used a special exception because it failed to show that it had followed the guidance.

- This breach had the potential to adversely affect the reputation of the RSL in particular and the sector in general.

We asked the RSL to terminate the contract, which it eventually did. We decided not to direct recovery of the money paid to the interim manager as the terms of the contract had been fulfilled, and directing recovery of the payments made would have impacted harshly on the individual. We required the RSL to undertake full training on Schedule 7 and other governance good practice. We supported the organisation with voluntary co-optees to strengthen its governance processes.

### **Lessons learned**

- RSLs need to be aware of the restrictions on employing close relatives of governing body members and existing staff.
- An RSL's recruitment policies and procedures should reflect this proscription and make sure a close relative is properly identified and excluded from potential employment.

## **Case Study 3: agreement to an out-of-court settlement with a former employee**

### **Schedule 7 Breach**

RSL C agreed to an out-of-court settlement with a former employee who was taking it to an employment tribunal. The settlement was for more than the amounts set out in special exception 4 which deals with an RSL making a voluntary severance payment to an employee which is outwith the contract of employment.

### **Our decision**

We decided this was a breach of Schedule 7 because:

- Schedule 7 prohibits payments to employees over and above what is in their contract of employment.
- Special exception 4 sets out the requirements which must be met by an RSL making a voluntary severance payment to an employee which is outwith the contract of employment.
- The RSL had made a payment to an employee which exceeded the specific terms of special exception 4.

### **Our actions**

In reviewing the breach and what action we would take we took account of these factors:

- The governing body sought and acted on legal advice to minimise costs to the organisation.
- The RSL's legal advice was that it should settle out-of-court as it was likely that the employment tribunal would award a higher level of compensation.
- All the organisation's procedures were followed.
- The RSL kept us informed of its actions.

Although there was a breach of special exception 4, we were satisfied that the RSL had acted to work within the terms and spirit of the legislation and in the best interests of the organisation. We did not direct recovery of the benefit in this situation as the RSL had taken and followed legal advice and avoided potentially having to pay a much larger sum of money.

**Lessons learned**

- RSLs need to understand how the Schedule 7 (special exception 4) provisions apply to decisions about making voluntary severance payments to staff outwith the contract of employment.
- It is important to seek expert professional and legal advice if there is a possibility of an employment tribunal to make sure the RSL can weigh up the risks and costs and come to a properly informed decision to achieve the best outcome for the organisation.

## **Case Study 4: contract with a business where one of the directors of that business was a close relative of a member of staff.**

### **Schedule 7 Breach**

RSL D had a contract with a business where one of the directors of that business was a close relative of a member of staff. The member of staff was not involved in setting up or running the contract. The RSL was not aware that there was a relationship between the business and its member of staff.

### **Our decision**

We decided this was a breach of Schedule 7 because:

- Schedule 7 prohibits an RSL from making payments to a business trading for profit where the principal proprietor or a manager of the business is a close relative of a governing body or staff member of the RSL.
- RSL D had a contract with the business.
- A member of staff in RSL D was a close relative of one of the directors of the business.

### **Our actions**

In reviewing the breach and what action we would take we took account of these factors:

- RSL D terminated the contract once it found out about the relationship between its member of staff and the business director.
- The RSL put measures in place to make sure that staff declared any possible conflicts of interest.

Although there was a breach of Schedule 7, we were satisfied that the RSL acted quickly and properly once it became aware of the breach. We did not direct recovery of the payments made to the business. We required the RSL to undertake further training for staff and governing body members on Schedule 7 and improve its procedures.

## **Lessons learned**

- RSLs must make sure that they have a register of interests for both their staff and governing body members to identify and manage any interest to avoid a potential Schedule 7 breach.
- RSLs need to be aware of the restrictions on awarding contracts to businesses owned or managed by close relatives of governing body members and existing staff.
- An RSL's procurement policies and procedures should reflect this proscription and make sure any close relatives are properly identified.

## **Case Study 5: payment to the senior staff member outwith the contract of employment**

### **Schedule 7 Breach**

RSL E paid money to the Director of the RSL that was not allowed for under the Director's contract of employment. The payment was in lieu of untaken annual leave.

### **Our decision**

We decided this was a breach of Schedule 7 because:

- Schedule 7 prohibits payments to members of staff over and above what is in their contract of employment.
- The RSL had made a payment to an employee which was not provided for under their contract of employment.

### **Our actions**

In reviewing the breach and what action we would take we took account of these factors:

- There was nothing in the Director's contract that allowed this payment to be made.
- There was no prior approval from the governing body of the payment (although the payment would have still been a breach even if approved).
- The payment was authorised by the Director and it was not checked for accuracy when the governing body retrospectively approved it.
- The governing body failed to demonstrate good governance; it did not understand its role as an employer, or that this payment represented a breach of Schedule 7, and it did not consider the consequences of its actions.
- The governing body initially failed to take the actions we required it to.
- This was a serious and material breach of Schedule 7.
- This breach had the potential to adversely affect the reputation of the RSL in particular and the sector in general.
- The employee offered to repay the sum involved.

Given the offer to voluntarily repay the inappropriate payment, we did not need to direct the RSL to recover the payment. We required the RSL's governing body and staff members to undertake appropriate training on Schedule 7. We also required it to review its internal systems and procedures to minimise the possibility of any further breaches of the legislation.

### **Lessons learned**

- The governing body must be aware of the terms and conditions within the staff contract of employment.
- Staff and governing body members need to understand the Schedule 7 restrictions on making payments outwith the contract of employment.
- The governing body needs to take any breach seriously and co-operate with the regulator to act quickly to restore confidence in the governance of the organisation.
- An RSL's finance systems should reflect its policies and procedures on Schedule 7 and ensure no unauthorised payments are permitted.

## About the Scottish Housing Regulator

The Scottish Housing Regulator (SHR) is an executive agency of the Scottish Government. We exercise independently the regulatory powers of Scottish Ministers in the Housing (Scotland) Act 2001. We [register](#) and [regulate](#) independent social landlords. These are usually housing associations, but they can also be housing co-operatives or companies limited by guarantee. We also [inspect](#) the housing and homeless services provided by local authorities.

We operate independently and impartially, while remaining accountable to Scottish Ministers for the standard of our work and for inspecting and reporting within the overall context of Scottish Ministers' strategic objectives for the social housing sector and tackling homelessness. A code of practice sets out what Ministers expect from us in delegating their regulatory powers to us. Our independence is further safeguarded by a Regulation Board that supports the Chief Executive to manage and direct the organisation.

Our purpose is to:

- protect the interests of current and future tenants and other service users;
- ensure the continuing provision of good quality social housing in terms of decent homes, good services, value for money, and financial viability; and
- maintain the confidence of funders.

Our work supports the principles of public service reform by promoting good services that are organised around the needs of the people who use them. We encourage registered social landlords (RSLs) and local authorities to be open, accountable, efficient and well governed. And we expect them to provide equal opportunity and open access to their services.

# [www.scottishhousingregulator.gov.uk](http://www.scottishhousingregulator.gov.uk)

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Government**



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