Grant Thornton

Registers of Scotland

Report on the 2008-09 Audit

29 July 2009

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1 Introduction

1.1 Purpose of the Report

1.1.1 We have audited the financial statements of the Registers of Scotland (RoS) for 2008-09, and examined aspects of RoS's performance and governance arrangements. This report sets out our key findings.

1.1.2 The report is also used to report to those charged with governance to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) (ISAUK) 260.

1.2 Our Responsibilities

1.2.1 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 2009 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
- 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
- information which comprises the management commentary, included with the Annual Report, is consistent with the financial statements.

1.2.2 We also review the Statement on Internal Control by:

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

1.3 Independence and robustness

1.3.1 Ethical standards require us to give you full and fair disclosure of matters relating to our independence.

1.3.2 We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the APB Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

1.4 Acknowledgements

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

1.4.2 This report is part of a continuing dialogue between RoS and Grant Thornton 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.

1.4.3 The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place on 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
29 July 2009

2 Executive Summary

2.1 Financial results

2.1.1 At 31 March 2009, RoS reported a deficit for the financial year of £4.6 million (2008: £11.2 million surplus). The operating deficit at £10.6 million was significantly below the budgeted surplus of £4.1 million. The deficit for the year reflects the downturn in the housing market leading to lower than expected activity in land registrations with a consequent impact on income.

2.1.2 RoS has recently updated its reserves policy in recognition that the existing financial projections require review in the current economic climate. RoS now projects that its accumulated surplus will fall over the next 5 years from the current level of £123 million to £36 million as the economic downturn continues to impact on the housing market. Whilst this forecast is subject to a high degree of uncertainty, we are satisfied that RoS's existing corporate planning arrangements are sufficiently robust and flexible to respond effectively to current market conditions. We note, however, that the level of losses projected may impact on the delivery of key corporate commitments. In particular, RoS has not yet brought forward plans indicating how it will now fund the extension of the Land Register.

2.1.3 The return on capital employed (ROCE) for the 3 year period to 31 March 2009 was 7% which is below the 10% statutory target set by Scottish Ministers. The lower than expected performance being due entirely to the effects of the downturn in the housing market on income levels. The consequent regularity failure is, in our view, entirely technical in nature and, as the target applies to the Keeper rather than RoS as a body corporate, does not require us to draw attention to the matter in our regularity opinion. We note that the 3 year ROCE target has now been adjusted to -6% for the 3 year rolling period to 31 March 2010, reflecting RoS's revised expectation that it will operate at a loss over this period.

2.2 Financial statements

2.2.1 We intend to give an unqualified opinion on the financial statements of RoS for the 2008-09 financial year and on the regularity of transactions undertaken during that year.

2.2.2 The draft financial statements were presented for audit on 18 June 2008, in line with the agreed timetable. 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. The main audit adjustments related to the work in progress balance, including:

- part of the WIP valuation process used an averaging method; that had not been updated to take account of the current market. Further analysis identified that that the impact of using actual fees decreased the work in progress balance by £757,000

- a small error in the calculation of the provision for complex cases reduced this provision by £32,000.

2.2.3 The net impact of these audit adjustments reduces the reported deficit for the year by £725,000.

2.3 Governance

2.3.1 We found that RoS's governance arrangements continue to operate well and within a generally sound control environment. We confirm that RoS complies with good practice guidance in relation to governance, as outlined in the Scottish Public Finance Manual, in so far as it is relevant to the role of RoS.

2.3.2 As part of the 2008-09 audit, we reviewed the systems of internal control in relation to core financial systems, IT systems and applications and compliance with the Data Protection Act 1998. Our audit found that the core financial systems continue to operate effectively, although arrangements for IT service continuity and the controls over access to IT systems and applications need to be strengthened. RoS has agreed to take action to address the weaknesses identified.

2.3.3 RoS has entered into a strategic partnership with BT for the development of a range of business critical IT systems. The overall expected outturn for the BT project to 2014 is now £119.5 million compared to the original contract value of £78.2 million, a variance of £41.3 million (52%). The variance reflects the cost of new projects commissioned since the partnership commenced. some changes to existing projects, and the cost of maintaining some legacy systems for longer than anticipated. During the year, RoS and BT commissioned a review of the partnership which brought forward a range of recommendations to improve strategic management and operational delivery arrangements. RoS is currently considering how to take forward the recommendations from this review. We plan to undertake a further review of RoS's progress in developing its partnership working arrangements with BT as part of our 2009-10 audit.

2.4 Performance

2.4.1 RoS has achieved, and in many cases significantly exceeded, the majority of its performance targets for the year. As noted above, RoS did not achieve its key financial target (ROCE) for the year and registration accuracy was only very marginally below performance expectations.

2.4.2 RoS has reported a decline in efficiency in production with the ratio of total costs to weighted outputs increasing from 70.7% to 88.9% in the three year period from 2006-07. This outcome is not unexpected in the context of the current economic climate.

Grant Thornton UK LLP
29 July 2009

3 Financial results

3.1 Income and Expenditure Account

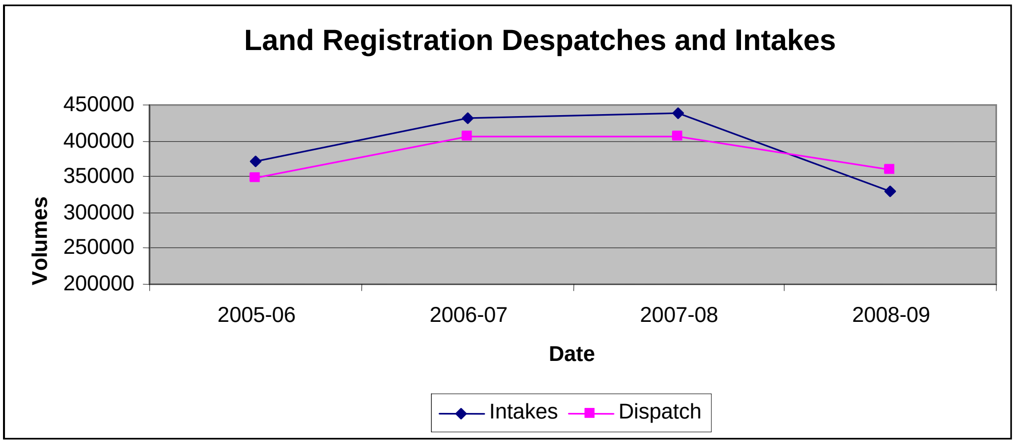
3.1.1 At 31 March 2009, RoS reported a deficit for the financial year of £4.6 million, a significant variance from the reported surplus of £11.2 million in 2008. Table 1 below summarises the financial results for the year.

Table 1: Financial results for the year ending 31 March 2009

Detail	2009 £'000	2008 £'000
Turnover	55,605	72,655
Staff costs	39,851	40,624
Depreciation	4,582	3,816
Other operating expenditure	21,729	17,455
Net interest	5,959	8,936
Dividend	-	(8,520)
Surplus/(Deficit) for the financial year	**(4,598)**	**11,176**

Source: Registers of Scotland

3.1.2 Turnover is significantly lower than the prior year due to the impact of the downturn in the housing market. The total number of land registration intakes has declined by 60,000 cases (14%), while despatches have declined by 58,000 (14%). The most significant reductions have taken place in Dealings with Whole (where intakes have declined by 23% due to the contraction in the mortgage market and the decline of specialist lenders - re-mortgages account for the majority of the decline). The chart below shows the trends in Land Register volumes over the past four years and highlights the decline in intakes experienced during the 2008-09 year.



3.1.3 There has been a £1.3 million increase in the level of provision in the accounts for work in progress balances during the year due an increase in the number of cases whereby costs to complete exceed the generated income. The increase reflects both the higher cost base during the year and the decline in registration volumes leading a higher cost per case.

3.1.4 Staff costs have declined slightly during year, due mainly to a reduction in the number of temporary staff required as a result of the declining volume of land registration cases. Other operating costs increased by £4.3 million (24%) from 2008 - the most significant element of the increase relating to a £1.2 million one off payment to BT for seconded staff. This payment was required as RoS is obliged under the partnership contract to provide staff for work managed by BT, and BT is entitled to charge a daily rate should staff not be available. The one-off payment resolves this matter going forward and management considers that the payment represents a lower cost outcome overall for RoS.

3.1.5 Net interest income is significantly lower than the prior year due to lower level of investments with the National Loan Fund, and the decline in the Bank of England base rate in the second half of the year.

3.1.6 On 1 April 2008, RoS repaid its Public Dividend Capital of £4.289 million to the Scottish Government. As result, RoS is no longer required to make dividend payments to the Scottish Consolidated Fund.

3.2 Budget outturn

3.2.1 RoS's 2008-09 financial projections forecast an operating surplus of £4.1 million for the year against the final outturn of an operating deficit of £10.6 million. The outturn variance against budget is explained by variances in both income and expenditure for the year. The budget outturn for 2008-09 is shown in Table 2 below.

Table 2: Budget outturn for the year ending 31 March 2009

Detail	2009 £'000	Budget £'000
Turnover	55,605	77,283
Operating costs	66,162	73,150
Operating Surplus/(Loss)	**(10,557)**	**4,133**

Source: Registers of Scotland/Corporate Plan 2008-2013

3.2.2 Turnover is behind budget due to the significant declines in land registration volumes as noted in Section 3.1. Although RoS forecast a reduction in turnover due to an expected slowdown, volumes were significantly behind actuals as the downturn was more severe than predicted.

3.3 Reserves

3.3.1 The accumulated surplus on the Income and Expenditure Account as at 31 March 2009 was £122.5 million (2008: £127.1 million). The reduction in reserves reflects the reported deficit for the year. The accumulated reserve balance has built up over the 5 year period from 2003-04 to 2007-08 as the increase in property prices resulted in high levels of income. The growth in the reserves slowed during 2007-08, as the fee reductions implemented from January 2007 started to take effect and has declined in 2008-09 due to the impact of the slowdown in the property market.

3.3.2 RoS has previously identified that it needs to hold reserves for both operational and investment purposes. The Board approved a formal reserves policy in August 2008 which set a minimum level of reserves for operational purposes of £56 million, and allocated £101 million to specific investment projects.

3.3.3 RoS had allocated £50 million of reserves to cope with a downturn in the housing market, however, it became apparent during the year that land registration volumes were declining faster than anticipated and that this would consume more reserves than allocated under the 2008 review. Accordingly the reserves policy was reviewed by the Director of Finance and Planning in May 2009.

3.3.4 RoS now projects that reserve levels will fall to £38 million by 2014 reflecting RoS's view that the market downturn is likely to continue for some time with a consequent impact of financial results over the business planning period (see section 3.5). . Accordingly, RoS cannot now fund all the planned investment programme from reserves and must meet the additional cost of any projects from current income levels or from external financing (for example, a loan from the National Loans Fund).

3.3.5 The most significant project for RoS, and a key corporate objective, is to increase the coverage of the Land Register. Although the majority of the land titles in Scotland are on the Land Register, the bulk of Scotland's land area is still held on the General Register of Sasines (as land held by the local authorities and the Crown does not change hands on a regular basis).

3.3.6 RoS was considering the need to subsidise the transfer of properties to increase the Land Register coverage as a key corporate objective. RoS has also noted that the Law Commission for Scotland has recommended that the General Register of Sasines be closed down at some point in the future. RoS recognises that achievement of the Land Register Extension (LRE) project will be difficult in light of the impact of the economic downturn on its financial position. As part of its corporate planning process, RoS is evaluating the appetite of stakeholders (including Ministers) for the LRE project, including likely costs and funding options.

Action plan point 1

3.4 Return on capital employed

3.4.1 Section nine of the Scotland Act 1998 sets out the financial arrangements for RoS and states that the Keeper of the Registers of Scotland is required "to achieve such financial targets as the Scottish Ministers may from time to time determine". The Scottish Ministers set the Keeper a financial target to achieve a 10% return on capital employed (ROCE) for the 3 year period to 31 March 2009.

3.4.2 For 2008-09, the actual 3 year ROCE achieved was 7%, due to the reported deficit in 2008-09 as the slowdown in the housing market took effect. The statutory target has not, therefore, been achieved.

3.4.3 We reviewed this matter as part of our 2008-09 audit and considered the potential impact of the failure to meet a statutory target on our regularity opinion. We concluded that the regularity failure was entirely technical in nature and, as the target applies to the Keeper rather than RoS as a body corporate, does not require us to draw attention to the matter in our regularity opinion.

3.4.5 We note that Scottish Ministers have since reduced the target ROCE to -6% for 2009-10. RoS, in its recent business plan update, anticipates that it will deliver a negative ROCE outcome for the foreseeable future reflecting its revised expectation that it will operate at a loss over the business plan period.

3.5 Looking forward

3.5.1 RoS published its corporate plan for the 5 year period to 31 March 2014 in January 2009. The corporate plan provides substantial revisions to previous financial projections, as more up-to-date information becomes available on movements in house prices and the volume of transactions.

3.5.2 The revised financial projections included in the corporate plan indicate that RoS will report an accumulated deficit of £86m over the 5 year planning period from 2009-10 as a result of the downturn in the housing market.

2.5.3 In addition, RoS faces other pressures on income, including a reduction in Registers Direct income as a result of lower prices introduced by the 2009 Fee Order, increases in ARTL uptake (as fees in ARTL are lower), and the impact of discounts offered as incentives for voluntary registration in the Land Register.

3.5.4 We note that current market conditions are unprecedented and future projections are subject to a high degree of uncertainty. In these circumstances all that management can sensibly do is scenario plan and continue to react on a timely basis to market movements. We are satisfied that RoS's existing corporate planning arrangements are sufficiently robust and flexible to respond effectively to current market conditions.

4 The Strategic Partnership Agreement

4.1 Introduction

4.1.1 On 1 December 2004, RoS entered into a strategic partnership agreement (SPA) with BT for the provision of all information systems and IT services. Under the terms of the SPA, all existing IT assets were transferred to BT. There are two aspects to the SPA agreement:

- the ongoing IT service provision which runs to 2014
- specific change programmes to update the IT systems and applications.

4.1.2 Our 2008-09 Audit Strategy Document identified the SPA as a business critical process subject to a high degree of risk. In particular, there is a risk that capital projects are not completed timeously, may not fully meet operational requirements, and may not represent value for money.

4.1.3 As part of our 2008-09 audit, we reviewed RoS's partnership arrangements with BT covering the following key areas:

- budget monitoring and management
- partnership management arrangements
- the contract amendment process
- dispute management.

4.1.4 RoS and BT have also commissioned a review of the SPA during the year by the consultancy firm Gartner. We have considered the outcomes from this review as part of our audit.

4.2 Financial position

Budget outturn

4.2.1 Total expenditure as at 31 March 2009 on the BT project was £70.7 million compared to the budget forecast of £66.3 million, a variance of £4.4 million (6.6%). The overall SPA is split into two initiatives:

- Back Office System Initiatives, which are systems used by RoS staff for processing and filing cases
- Public Facing System Initiatives, which are systems used by both third parties and the public with input from RoS.

4.2.2 Contract changes of £2.9 million reflect requests by RoS to change the original contract due to changing system requirements. This created extra funding requirements, mainly relating to the Back of Office Service Initiatives (BOSI) and Public Facing Service Initiatives (PFSI).

4.2.3 Additional costs of £21.1 million have been incurred, the bulk of which relates to:

- £1.4 million relating to the elements of the ARTL system which could not be determined at the time the project was agreed (digital signatures)
- £4.8 million for the Registers Archive Conversion Project, a joint project with the National Archives of Scotland, which was initiated after the SPA contract commenced
- £1.9 million for the Register of Floating Charges, a new statutory register introduced by the Bankruptcy and Diligence etc. (Scotland) Act 2007, another project initiated after the SPA contract commenced
- £1.4 million for the Integrated Registration Project, a back office initiative to streamline and automate the registration process. RoS has made several changes to this project as additional system functionality was required from the initial agreed project.
- £2.7 million for the costs incurred on legacy systems which will continue to be operate due to the delay in other projects.

4.2.4 Indexation costs have been significantly higher than expected mainly due to the impact of indexation on contract changes and additional costs, and the spiked increase in the retail price index during 2007-08, which the contract used as a reference point for indexation.

4.2.5 Overall, the BOSI projects are within budget, with the budget overspends in IRP and ERDM offset by budget savings in the e-Settle project.

4.2.6 In the PFSI projects, there was an overall budget overspend of £4.4 million (8%). This includes a £0.9 million penalty charge imposed by RoS on BT for failure to deliver Automated Registration of Title to Land (ARTL) within the agreed timeframe. The main projects showing overspend are as follows:

- BT Service Charges are overspent by £3.3 million (10%) and reflects additional service charges associated with changes to the capital project specifications
- BT Legacy Costs are overspent by £1.4 million (50%) and reflect the extra cost borne by RoS for running legacy systems due to delays in PFSI projects (including ARTL.

4.2.7 A more detailed summary of outturn against budget to 31 March 2009 for each project being delivered through the partnership is contained at Appendix C.

Expected budget outturn till 2014

4.2.8 The overall expected outturn for the BT project is now £119.5 million, including new projects, compared to the original contract value of £78.2 million, a variance of £41.3 million (52%). The variance reflects the cost of new projects commissioned since the partnership commenced, some changes to existing projects, and the cost of maintaining some legacy systems for longer than anticipated. Slippage is forecast across both the Back Office Systems Initiative (BOSI) and the Public Facing Systems Initiative (PFSI).

4.2.9 Table 3 below highlights the variances between the capital programme and expected (but not necessarily committed) capital expenditure for the BT contract.

Table 3: The Strategic Partnership Agreement budget outturn

Component	£million	Details
Original budget per contract	78.2	Original budget per Schedule 14 of the contract
Contract changes	2.9	Changes made to the original Schedule 14
Additional costs	21.1	New projects or significant changes in addition to Schedule 14
CCN Service Costs	7.6	The costs of implementation of contract change notices (CCN)
Indexation	9.7	Inflationary rate built into the contract
Total	**119.5**	

Source: Registers of Scotland (The Keeper's Report March 2009)

4.3 Contract management

Contract amendments

4.3.1 The procedures for amending details of the contract are set out in the change protocol document, developed by the Partnership and Change Group. The aim of the protocol is to implement a transparent change process where roles and responsibilities are clearly defined to manage change effectively. Our review considered that adequate arrangements were in place to manage contract amendments.

Overruns

4.3.2 The terms of the partnership mean that most cost overruns are borne by BT. The price of individual projects are fixed at inception, with BT liable for any overruns. Cost overruns caused by project amendments are paid by RoS as they occur. The SPA also includes contract terms for liquidated damages penalties for failure to meet deadlines for delivery. We noted that these penalties were applied to the ARTL project.

4.3.3 The terms of the contract do transfer the bulk of the risk for cost overruns and failure to meet deadlines to BT. While this arrangement protects RoS to an extent from the bulk of the risk, it does lead to a higher charge from BT to compensate for the risk premium in the SPA.

Performance Evaluation

4.3.4 The terms of the partnership incorporate a review process at the 3 year and 7 year stages. As part of the review process, RoS and BT commissioned a report by Gartner on the partnership. The report's objectives were to review the how the partnership is working overall, to compare the core service delivery against other industry comparators, and to identify gaps and areas of improvement in the partnership.

4.3.5 The Gartner report was finalised in February 2009 and concluded that the partnership was working effectively and that value for money was being achieved by RoS. It was noted that the price paid by RoS for the core service delivery was higher than the market average by £300,000, however this was within a 10% variance which is considered acceptable for such contracts. The Gartner report identified some weaknesses identified in the partnership, and these are summarised below:

- the level of penalty for delivery failures is potentially 100% of the monthly service charge versus market norms of 10-20%. This arrangement may increase the cost to RoS as BT will charge more to compensate for the higher risk
- there is misalignment between RoS and BT on the vision and direction of the partnership
- there are some relationship difficulties caused by the delivery timescale of projects.

4.3.6 Gartner makes a number of recommendations to help address the weaknesses. RoS is currently considering the outcomes from the Gartner review and plan to produce an action plan to address the key issues emerging from the review. We will continue to monitor RoS's progress in addressing the issues raised through the Gartner review.

Partnership Board

4.3.7 A Partnership Board currently meets on a bi-annual basis to monitor the SPA. The Board includes senior RoS staff, including the Keeper and is responsible for the overall strategic arrangements of the partnership. The Partnership and Change Group meet on a monthly basis to monitor the partnership at an operational level.

4.3.8 The Gartner report has recommended that the Partnership Board meet on a more regular basis. RoS have now decided to hold meetings on a quarterly basis.

4.4 Looking forward

4.4.1 The SPA is now in its 5th year, the mid point of the contract. This is an ideal opportunity for management, building on the Gartner review, to take stock of how best to take forward the strategic development of the partnership with BT and management should undertake an evaluation of the following key areas:

- the current position with regards to expenditure committed, projects completed and whether the SPA has achieved the impact and success envisaged at the outset
- the position with regards to future projects planned but yet to be commissioned in the context of revised corporate priorities and financial plans
- an options appraisal for the way forward.

Action plan point 2

4.4.2 The SPA is scheduled to run to 2014. At that point, assets held by BT under the SPA will transfer back to the legal ownership of RoS. The future of the SPA will be a significant issue for RoS to consider for the provision of IT services after 2014. From our review, we noted the following key issues:

- there is a high degree of dependency on BT by RoS as many of the IT solutions delivered under the SPA are bespoke and will continue to require support from BT beyond 2014
- BT have detailed and specialist knowledge of the IT systems and applications used by RoS, and this may make it difficult to put out a new tender for services beyond 2014
- there is no contingency plan in place in the event that BT (or RoS) terminate the contract early.

4.4.3 Our audit confirms that RoS are aware of these issues and, whilst a number of options have been considered informally, a formal options appraisal review exercise has not been undertaken to consider how best to manage the transition arrangements when the SPA ends.

Action plan point 3

5 Financial statements

5.1 Audit Opinion

5.1.1 We expect to give an unqualified opinion on the financial statements of RoS for the 2008-09 financial year. 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 2008 to 31 March 2009 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.

5.2 Audit Quality

5.2.1 The draft financial statements were presented for audit on 18 June 2009, in line with the agreed timetable. The accounts and supporting working papers continue to be of a good standard and, as a result, few adjustments were required to be processed following our audit.

5.3 Statement on Internal Control

5.3.1 The Statement on Internal Control sets out the arrangements established and operated by RoS for reviewing the effectiveness of the system of internal control and the identification and management of risk.

5.3.2 We are satisfied that the Statement complies with Scottish Government 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.

5.4 Accounting issues

Work in progress

5.4.1 ROS holds significant amounts of work in progress (WIP) in its balance sheet at the end of the financial year. This represents the value of land registration transactions processed in the period for cases that are not yet completed. The calculation of WIP requires RoS to collect significant amounts of financial information on cases and the calculation process can be complex.

5.4.2 As at 31 March 2009, the value of WIP in the balance sheet was £3.8 million (2008: £6.5 million). The significant decline in WIP balances reflects:

- a fall in land registration volumes, meaning outtakes exceed intakes over the financial year

- a new provision of £1.3 million offset against the WIP balance to represent the shortfall in fee income for very complex case work.

5.4.3 We noted the following issues with the WIP balance for the 2008-09 accounts:

Calculation of WIP

5.4.4 WIP is valued in the balance sheet at the lower of either the cost to complete the case or the revenue received from the case - i.e. the net realisable value (NRV). The NRV was calculated based on average fees per case multiplied by an average number of deeds per case. As part of our audit, we re-performed the WIP calculation based on the actual revenue figures from the ledger which identified a significant overstatement of £757,000 in the WIP value recorded in the draft accounts.

5.4.5 In addition, we also identified a small error in the calculation of the WIP provision, which when corrected reduced the provision by £32,000. These errors have resulted in a net reduction of £725,000 in the value WIP recorded in the revised accounts.

Costs

5.4.6 The average cost for each class of WIP has been adjusted in 2008-09 as a result of the down turn in the property market. The current year costs are not expected to be an accurate reflection of costs going forward, as the current year included high training costs. Due to the down turn, RoS has reallocated existing staff to more complex cases and has experienced higher than usual one off training costs. It is not possible to accurately identify the extent of these one off costs, as timesheets are not sufficiently detailed.

5.4.7 Management have therefore taken an average of the last three years costs, weighted 50% towards the current year, to reflect that costs going forward are expected to be somewhere between these years.

WIP reconciliation

5.4.8 The available breakdown of WIP in the ledger at the year end is analysed by deed, however, the detailed breakdown of WIP in the registration system (IRIS) is analysed by case. As a result, reconciliation of the two systems proved problematic during the audit process and impacted on the level of assurance available to confirm the case numbers, and therefore revenue, for WIP cases matched. It was also difficult to trace our sample from the WIP count to the year end figures to ensure our sample could be verified in the ledger.

5.4.9 Management were able to provide a reconciliation of WIP as at 3rd July 2009 which confirmed that stock recorded in the ledger and IRIS systems matched. From this we were able to review the reconciling items to gain comfort that the systems operated effectively for the 31 March 2009 calculation.

5.4.10 We have recommended that management prepare a reconciliation at the year end to reconcile WIP balances between the IRIS and ledger systems. In addition, a list of individual WIP balances should be maintained to allow the WIP count results to be verified to the year end accounts.

Action plan points 4 and 5

Bank reconciliations

5.4.11 The Paymaster General bank reconciliation for 31 March 2009 was prepared on a cash basis, with a journal processed to ensure the ledger balance matched the bank balance. This is a departure from the usual method of completing a bank reconciliation, whereby the bank balance is reconciled to the ledger. Our audit identified that this process led to £299,416 of payments being processed as a creditor when in fact they related to the 2009-10 accounting year. The draft accounts have been adjusted to correct this error.

5.4.12 RoS should review the process for preparing the Paymaster General bank reconciliation to ensure it is completed correctly.

Action plan point 6

5.5 Misstatements identified by the audit

5.5.1 This is a summary of accounting adjustments identified by the audit. Table 4 below lists the adjusted audit differences following our audit.

Table 4: Audit differences

Adjustments effecting reported results	I&E Account		Balance Sheet	
	Dr £'000	Cr £'000	Dr £'000	Cr £'000
Works in progress To adjust the WIP calculation to use actual revenue figures rather than average fees	WIP movement 757			WIP 757
Works in progress To correct error in the WIP provision calculation		WIP movement 32	WIP provision 32	
Bank reconciliation To reverse a journal posted at the year end to adjust the ledger balance to equal the Paymaster General account balance.			Sundry creditors 299	Bank 299
Debtor reclassification Reclassify advance payment of early retirement costs as a prepayment			Prepayment 190	Other debtors 190
	757	**32**	**521**	**1,246**

5.5.2 Table 5 below lists the adjusted audit differences following our audit.

Table 5: Unadjusted audit differences

Adjustments effecting reported results	I&E Account		Balance Sheet	
	Dr £'000	Cr £'000	Dr £'000	Cr £'000
Debtor reclassification To reclassify prepaid BT legacy costs			Prepayment 402	Other debtors 402

5.5.3 We also identified a small number of minor disclosure amendments to improve the presentation of the accounts. The Accountable Officer has updated the draft accounts to incorporate these changes.

6 Governance

6.1 Introduction

6.1.1 Corporate governance is the system by which organisations direct and control their functions and relate to their 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.

6.1.2 As part of our 2008-09 audit, we assessed the adequacy of RoS's governance arrangements against good practice standards for the public sector. We examined:

- the operation and effectiveness of key controls over IT systems and applications
- the operation and effectiveness of key controls over financial systems and processes (financial management and budgetary control, income and accounts receivable, fixed assets and provisions)
- audit committee arrangements
- the progress in implementing agreed recommendations arising from our 2006-07 and 2007-08 audits.

6.2 Findings

6.2.1 Overall, we found that RoS's governance arrangements operated well and within a generally sound control environment. RoS complies with the good practice guidance in relation to governance, as outlined in the Scottish Public Finance Manual, in so far as it is relevant to the role of RoS.

IT systems and applications

6.2.2 There were 9 outstanding IT action plan points from our 2007-08 audit, of which 3 were not implemented, 4 partially implemented and 2 ongoing. The lack of progress in implementing agreed recommendations is largely explained by management attention being diverted to managing IT projects through the SPA.

6.2.3 A summary of progress of implementation on the outstanding IT action points is included in our IT follow up report issued in July 2009.

Core financial systems

6.2.4 Our overall conclusion is that the core financial systems continue to operate effectively. In particular, RoS has good controls over expenditure and cash management systems. Our interim audit did not identify any high risk observations but made 9 recommendations to improve internal control arrangements. Our key findings are outlined below:

- the level of contingency built into departmental budgets is not quantified at the budget setting stage and is not separately identified in budget monitoring reports

- WIP counts had not been undertaken throughout the 2008-09 financial year, although one WIP count was subsequently undertaken in early April 2009

- some of the calculations used for the WIP balance in the management accounts are based on historic information that has not been updated for some time.

Audit committee arrangements

6.2.5 We reviewed the audit committee arrangements against the guidance contained within the Scottish Government's handbook: Guidance for audit committee members in the core Scottish Government. We found that the audit committee complied with the principles of the handbook.

6.3 Internal Audit

6.3.1 Following a competitive tendering exercise during 2007-08, RoS appointed Pricewaterhouse Coopers as internal auditors. The internal auditors have concluded that they "can give moderate assurance on the design adequacy and effectiveness of the system of internal control".

6.3.2 Internal audit issued five reports during 2008-09 and deferred the audit of the BT Partnership until 2009-10. Twenty six recommendations were made to management, of which 12 were regarded as high risk. The bulk of the high risk recommendations arose from the review of the Change Programme.

7 Performance

7.1 Introduction

7.1.1 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.

7.1.2 The Accountable Officer 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.

7.2 Efficiency

7.2.1 RoS is committed to improving the efficiency of its operations by reducing the standard production cost index by at least 1% for the 3 year period to 31 March 2009. Efficiency is measured by the ratio of total costs to weighted outputs.

7.2.2 For the year ending 31 March 2009, RoS reported an increase of 4.9% in the ratio of total costs to weighted outputs over a three year period to 2008-09 compared to the three year period to 2007-08 and did not therefore meet its target. This outcome is, however, entirely due to the significant decline in caseload experienced during the year, the resulting increased focus on clearing very complex casework, and the additional costs of staff training required to support that change. Table 6 below provides more information on the change in unit costs over the period reviewed:

Table 6: Efficiency Savings: Production Cost Index

Detail	Unit Cost Index £
3 years to 2006-07	70.36
3 years to 2007-08	70.72
3 years to 2008-09	88.85

Source: Registers of Scotland

7.3 The Keeper's performance targets

7.3.1 The Keeper sets key performance targets each year for the organisation. RoS has achieved, and in may cases significantly exceeded, the majority of its performance targets for the year. As noted earlier in this report, RoS did not achieve it's key financial target (ROCE) for the year and registration accuracy was only very marginally below performance expectations. Table 7 below provides a more detailed summary of the 2008-09 outturn against the Keeper's performance targets:

Table 7: Keeper's performance targets outturn

Detail	Target	Outturn
Sasine turnaround time	To complete the recording of 80% of Sasine writs within 20 working days; with the remainder to be completed within 40 working days	Achieved. 93% of Sasine writs completed within 20 working days, none over 40 days.
Dealings with whole turnaround time	To complete the registration of 60% of Dealings with Whole within 30 working days; with the remainder to be completed within 100 working days.	Achieved. 94% of Dealings with Whole registered within 30 working days, none over 100 days.
First Registrations turnaround time	To complete the registration of 70% of standard First Registration applications within 70 working days	Achieved 92%
Complex cases	- To eliminate all pre-January 2006 First Registration casework	**Achieved**
	- To complete registration of 25,000 Transfers of Part cases, along with their consequential Dealings with Whole	**Achieved**
Registration accuracy	To achieve a registration accuracy rate of 98.5% for applications despatched during the previous 12 months	Actual performance was 98.34%

Source: Registers of Scotland

Grant Thornton UK LLP
29 July 2009

A Action plan

No	Finding	Risk	Recommendation	Management Response	Implementation Date
Reserves					
1	RoS has not yet determined how the key Land Register Extension (LRE) project will be funded going forward.	Medium	RoS should consider a further revision to its financial projections to identify how the Land Register extension project will be funded.	LRE is currently a key Ros objective however, given the econ downturn, it is necessary to reappraise this. As part of the Corporate Planning process, we intend to explore the appetite of stakeholders, including Ministers, for LRE; this process will include identifying the likely costs and funding options	28/02/10
Strategic Partnership Agreement					
2	The SPA is now in its 5th year, the mid point of the contract. This is an ideal opportunity for management, building on the Gartner review, to take stock of how best to take forward the strategic development of the partnership with BT.	Medium	RoS should prepare a position statement on the SPA to analyse the current position with regards to committed expenditure, future projects not yet commissioned, and perform an options appraisal on the best way forward.	Agree Options analysis is due to be completed by April 2010	April 2010

No	Finding	Risk	Recommendation	Management Response	Implementation Date
3	RoS has not developed a contingency plan covering how the organisation will respond in the event the partnership agreement with BT is terminated or comes to an end.	Medium	RoS should develop a contingency plan setting out arrangements for taking forward the objectives in the SPA at the end of the contract in 2014 or in the event that the contract is terminated earlier.	Agree This should be developed alongside the options analysis identified at 2 above.	April 2010
Work in progress					
4	Management were unable to accurately allocate training costs to the WIP calculation due as insufficient data in this area, increasing the risk of error in the WIP calculation.	Medium	RoS should review arrangements for capturing the relevant cost information for the WIP calculation	RoS is undertaking a general review of cost capture processes.	January 2010
5	A reconciliation between the general ledger and the WIP management system (IRIS) is currently not performed. In addition, an analysis of the WIP balance by case is not prepared to support the year end WIP calculation. This reduces the available audit evidence supporting the WIP calculation.	Medium	RoS should perform a reconciliation of the general ledger and IRIS on a regular basis, and to support the WIP calculation in the annual accounts. RoS should also prepare an analysis of WIP balances by case and deed to ensure WIP counts can be traced through to the balance held in the accounts.	Agree The Management Accounting Team will carry out quarterly reconciliations. The Management Information Team will ensure end of year WIP application analysis reports are run.	September 2009

No	Finding	Risk	Recommendation	Management Response	Implementation Date
Bank reconciliations					
6	A journal was processed incorrectly to the Paymaster General account to make the ledger balance match the bank statement balance. This is not the correct method of performing a bank reconciliation and there is a risk of misstatement in the accounts.	Low	The reconciling items should not be posted to the General Ledger	Agreed	From September quarterly accounts

B Progress in implementing prior year recommendations

No	Original finding and risk	Recommendation	Management Response and Implementation Date	Position at July 2009
1	The housing market in the United Kingdom has seen a significant slowdown during 2008-09, and this is expected to continue into 2009-10. Risk: Medium	RoS should re-visit the financial projections contained within its corporate plan in light of the potential impact of the housing market slow-down.	RoS routinely reviews its financial projections during the year, and has already recognised the implications for this year. Current year figures will be reviewed initially by the date shown and will be kept under review during the year. Later years will be looked at as part of the fee review process. **Implementation: 18 March 2008**	**Implemented** The corporate plan for 2009-2013 has been updated to take account of the slowdown in the housing market. In addition, the reserves policy has been updated.
2	The 2008-09 Business Plan analysis notes that, in addition to the impact on turnover, a fall in intakes will lead to a less efficient utilisation of staff in the short term. RoS has not yet set out how it will maintain staff utilisation during the market slow-down. Risk: Medium	RoS should set out a contingency plans for managing potential under-utilisation of staff in the event that market slow-down is considered to have an impact beyond the financial year.	RoS routinely manages the redeployment of staff, depending on the availability of casework. We recognise that there is a risk that the scale of this issue may be greater this year than it is habitual; however the effect of the downturn is partly offset by low ARTL take up and the level of arrears. We expect to review this continuously. **Implementation: Ongoing**	**Partially Implemented** RoS have reduced temporary staff as land registration volumes have declined over the year. In addition, the process of allocating permanent staff to more complex case work has started.
3	Our review of the provision for indemnity claims as at 31 March 2008 found one claim with an estimated value of £80,000 that had not been recorded in the financial statements. Risk: Low	RoS should ensure that all relevant indemnity claims are identified and if necessary included in the indemnity provision, in line with FRS 12.	Accepted. It is recognised that existing procedures failed to pick up this future liability. The procedures have been widened to include possible litigation cases. **Implementation: 2008-09 Q2 accounts**	**Implemented**

C Strategic partnership - analysis of project outturn

The budget outturn to 31 March 2009 for each project being developed through RoS's Strategic Partnership with BT is shown below:

Budget outturn as at 31 March 2009

Project	Outturn (to date) £'000	Budget £'000	Variance £'000	% Variance
Back Office System Initiatives (BOSI)				
IRP	4,862	4,646	216	4.6%
EDRM	2,162	2,117	45	2.1%
e-Settle 1	1,360	1,568	-207	-13.2%
Subtotal	**8,384**	**8,331**	**54**	**0.6%**
Public Facing System Initiatives (PFSI)				
ARTL	3,024	2,934	90	3%
ARTL Delay Charge	-914	0	-914	n/a
NANs	82	82	0	0%
eServices	270	270	0	0%
De-materialisation	289	289	0	0%
Registers Direct 2	519	517	2	0.4%
eForms	247	247	0	0%
Registers Archive Conversion	4,479	4,453	26	0.6%
Systems Refresh	8,554	8,554	0	0%
BT Service Charges	34,146	30,819	3,327	10.8%
CCN Service Charge	666	775	-110	-14%
BT Legacy Costs	4,153	2,752	1,401,	51%
Other Projects	6,798	6,269	529	8%
Subtotal	**62,313**	**57,961**	**4,351**	**7.5%**
Total BOSI and PFSI	**70,697**	**66,291**	**4,405**	**6.6%**

Source: Registers of Scotland (The Keeper's Report)

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