

In brief

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Learning from financial problems

This In Brief summarises good practice guidance for associations on financial management. The guidance derives from research into associations' difficulties and includes advice on liquidity and treasury management, control of growth, business planning, project appraisal, stock investment, management accounting, accounting policies and audit. It was researched and written by Dermot McRoberts of EMA Business and Management Consultancy Ltd and the full report is available from the Housing Corporation website.

Introduction

Guidance on good practice in financial management has been derived from research into the causes of, and responses to, difficulties encountered by a diverse range of associations. The recommendations are based on empirical evidence drawn from nine RSL case studies, all of which had been placed in supervision by the Housing Corporation due, in part or wholly, to concerns about their financial governance and management. A detailed review of Housing Corporation regulation and supervision records were supplemented with interviews of senior executives involved in resolving the various associations' problems. The guidance is accompanied

by various appendices illustrating the reporting formats and other key principles discussed. The examples are intended to provide general guidance and illustration only and will clearly not be appropriate in all circumstances.

Key findings

The key points of good practice guidance are organised into sections which consider the following aspects of financial management:

- liquidity management;
- treasury management and funding;
- control of growth and diversification;
- business planning and project appraisal;
- stock investment – large-scale voluntary transfer associations;
- management accounts and reporting; and
- accounting policies and audit.

Some of the key financial management and governance failures by case study registered social landlords that led to the guidance recommendations included:

- poor cash management, including failure to relate debt funding requirements to the capacity to service that debt or ability to raise it, resulting in near insolvency;
- lack of control over security records such that an RSL had no ability to assess its capacity to raise new loan finance to meet contractual commitments arising from committed investment programmes;
- lack of appreciation of the significance of contractual obligations to funders and of processes for monitoring adherence to loan covenants set out in loan agreements;
- over-ambitious and over-optimistic growth through diversification, such that feedback on early experience was not analysed and interpreted to influence future projects, or through over rapid expansion such that insufficient time was allowed to learn from and build on experience;
- weak project appraisal and control mechanisms, notably failure to establish prudential limits to the scale of projects undertaken or lay down appropriate, relevant controls over project viability assessments and link these to the business planning process;
- deficient business planning practices ranging from use of inaccurate and inconsistent business planning information through to a lack of use of long-term business plans to help frame

and control financial strategy and growth initiatives;

- poor control of large-scale voluntary transfer investment programmes through a lack of differentiation between key budget heads and a failure to analyse cost behaviour in sufficient detail to achieve the required level of control;
- failure to produce trading accounts and other management information required to secure effective financial control over direct maintenance units;
- weak management accounting practices, including a wide range of deficiencies from insufficient information to excessive detail, lack of concise narrative and absence of meaningful forecasts; and
- use of aggressive accounting policies that served to overstate the relative financial strength of registered social landlords through reporting exaggerated levels of annual surplus that in turn led boards to take on more financial risk than was appreciated.

The good practice guidance derived from the above evidence is as follows:

- all associations need to monitor and manage their liquidity position continually. A forward rolling cash flow forecast for at least one year ahead should be produced and reviewed quarterly, mapped onto the sources of finance;
- security records must be carefully ordered, kept fully up to date and cross-referenced to forecast liquidity requirements – this is essential to help avoid the risk of overtrading;

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- current and forecast financial ratios set out in funders' loan covenants should be monitored over the short term (one year) via management accounts and over the longer term through the financial business plan;
- associations entering into areas of new business should ensure that the lessons of diversification are fully assimilated prior to repetition of projects;
- associations must understand what their financial capacity for growth is and set prudential limits for this, eg on the maximum gross cost of individual development projects and the overall programme of pipeline projects;
- long-term financial business plans should be at the centre of all major strategic financial decisions taken by boards. Business plans need to be owned by board members and executives, reconciled to operating budgets and be fully consistent with project appraisal assumptions. Business plans should identify key relationships between major cost and income items but should not be excessively detailed;
- boards need to fully understand the nature of their project appraisal process and exercise control over all discretionary elements. Arrangements for project approval and the level of delegated authority granted to executives must be explicit. The rationale for any internal subsidies must be clear, with sustainability demonstrated via analysis of the financial business plan;
- effective financial control of major stock investment programmes, such as those carried out by large-scale voluntary transfer associations, can only be achieved with cost volume variance analysis and ring-fencing of improvement budgets;
- comprehensive trading accounts should always be prepared for direct building maintenance units operated by some associations, and boards should review summary trading accounts each quarter;
- boards should receive quarterly management accounts that provide a succinct overview of the association's financial position, a forecast for the year end, details of loan covenant compliance and meaningful reports on key exceptions. Executives, not boards, should focus on supporting details;
- boards should resist the temptation to employ generally aggressive accounting policies and should always seek their auditor's frank opinion on any proposed changes; and
- associations need to ensure that they employ finance staff with the qualifications, skills and experience commensurate with the complexity of their business.