

## Overseeing Focus Housing Association



**Report by the  
Comptroller and Auditor General**

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**The Housing Corporation**

# **Overseeing Focus Housing Association**

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This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

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Comptroller and Auditor General

National Audit Office  
18 July 2000

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# Executive summary

## Background

**1** In April 2000, three men were sentenced to prison terms for corruption in relation to the purchase of homes from a Birmingham property dealer (see box) by Focus Housing Association (Focus), the largest registered social landlord in the West Midlands. Between 1991 and 1995 the property dealer made corrupt payments to two Focus employees to ‘oil the wheels’ for the purchase of around 50 homes by Focus for £1.8 million. Focus uncovered the corruption in November 1995, as a result of an anonymous tip-off, and informed the Housing Corporation (the Corporation).

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### Corruption and overpayments at Focus

Between 1991 and 1995 Focus Housing Association bought at least 47 houses for £1.8 million from Darshan Ram, a Birmingham property dealer. These purchases were organised by Focus’ deputy development director, John Hartshorn and his assistant, Keith Hinson. Over the period, Focus bought a further 95 rental properties from other property dealers.

Most of the properties Focus bought from Ram were back-to-back deals, that is Ram had himself purchased the properties on the open market only a day or two before selling them to Focus.

Ram paid Hartshorn and Hinson at least £5,450 and £16,300 respectively to reward them for the favourable treatment they showed him. In April 2000, Ram was sentenced at Birmingham Crown Court to 18 months imprisonment, Hartshorn was sentenced to 12 months and Hinson 9 months.

Investigations at Focus found that the Association paid more than market value for many of the properties it bought from property dealers, although only Ram appears to have made corrupt payments as an inducement for the deals.

**2** Subsequent investigations by Focus found that it had paid more than the market value for the properties. Other overpayments relating to the purchase and renovation of properties by Focus were also uncovered. As a result of these overpayments, it is estimated that Focus and its tenants have borne the cost of unnecessary expenditure of £1.09 million, although the actual sum may be lower or higher than this because property valuation is not an exact science. Focus was able to recover £250,000 of this loss from its insurers. Focus was also required to pay back grant of £198,000 to the Corporation for sums overpaid on these properties.

**3** This report examines the Housing Corporation’s oversight of Focus Housing Association. We examined the Corporation’s regulation of Focus from the Association’s formation in 1991 to 1998, when the Serious Fraud Office decided to

instigate criminal proceedings. We reviewed files held by the Housing Corporation at its headquarters and at its West Midlands regional office, and files held at Focus. We also interviewed relevant staff at Focus and the Corporation's headquarters and received information from former staff from the Corporation's West Midlands regional office. Now that the prosecution has been brought to a close, the matters central to this report are no longer sub judice and we are able to report our findings.

**4** Part 1 of this report describes the corruption and overpayments suffered by Focus in more detail, and outlines the Housing Corporation's role in relation to Focus and other registered social landlords. Part 2 examines the Corporation's oversight of Focus and considers whether it did enough to detect and act on the weaknesses at Focus prior to being notified of the fraud allegations, and whether it took appropriate action after being notified. Part 3 examines the wider implications of the Focus case, in particular what the Corporation did to determine whether Focus was an isolated case and the steps it took to prevent a reoccurrence of the type of property fraud and mismanagement which occurred at Focus.

## **Main findings**

**5** Our main findings are set out below.

### **The Corporation's reviews of Focus before 1995 did not identify the potential for fraud and corruption**

Between 1991 and 1995 the Corporation carried out regular routine reviews of Focus. Although these reviews identified procedural weaknesses at the Association, they failed to highlight the lax management culture and disregard of internal control within the Association's development function, which allowed the corruption to take place and remain undiscovered for four years (paragraphs 2.1-2.6). A Corporation internal investigation of its regulation of Focus identified weaknesses in its regulatory procedures, which it revised in the light of experience in this case (paragraphs 3.6-3.7 and 3.10).

### **The Corporation should have taken more action in response to allegations it received in 1994**

The Corporation did not take sufficient steps to investigate allegations of corruption by Hartshorn it received in 1994. It did not inform Focus in writing of the allegations and other information it possessed, nor ensure that Focus carried out an investigation into the allegations (paragraph 2.8). The Corporation's own investigation found mistakes in the way it had dealt with the allegations. More

vigorous action by the Corporation could have resulted in closer attention being paid to Focus' development function, and this in turn might have led to the corruption and overpayments being discovered earlier (paragraphs 3.8-3.9).

**When Focus reported the corruption, the Corporation took prompt and effective action to improve Focus' management**

After Focus itself reported corruption allegations to the Corporation in November 1995, the Corporation took prompt and effective action to investigate and protect public money and placed Focus under close supervision (paragraph 2.9). Focus has improved its management and performance, a process which began with the arrival of a new Chief Executive in April 1994, and since 1997 the Corporation has no longer considered the Association as a cause for concern (paragraph 2.12).

**The Corporation took steps to ensure that other housing associations were unaffected by similar corruption**

Upon the discovery of the corruption and overpayments at Focus, the Corporation took immediate action to investigate the property dealings of other West Midlands registered social landlords. The investigation was hampered by difficulties in obtaining complete data on associations' property dealings but found no evidence of back-to-back property deals or purchases from Ram or his nominees by other landlords in the West Midlands area (paragraph 3.2-3.5).

**The Corporation reviewed its regulation of Focus, and revised its procedures as a result**

As a direct result of the Focus case, and its investigations into its handling, the Corporation redesigned its regulatory systems to obtain greater assurance that landlords in receipt of significant development grants have effective systems of internal controls. Since 1995, it has also introduced other regulatory changes designed to enhance the standards of management and governance within landlords and its regulation of those standards (paragraphs 3.11-3.13).

**Now that the criminal case is over, the Corporation intends to disseminate the lessons learned from this case**

The Corporation employed consultants to review the lessons learned from this case, but criminal proceedings meant that these could not be published. Now that the case is no longer sub judice, the Corporation intends to publish the lessons of the Focus case to other registered social landlords (paragraphs 3.14-3.15).

## Conclusions

**6** The Corporation's regulation of Focus before 1995 could have been better, and the corruption possibly brought to light sooner. However, the Corporation did react quickly and positively to the corruption's eventual discovery in November 1995. The Corporation has also taken steps to review and improve its regulatory processes, and plans to disseminate the lessons learned from this case. Our main conclusions are:

- regulators should be concerned not just with the existence of internal controls within the bodies they regulate, but also with their continued operation. In particular, it is important that they be assured that there is a management culture which does not allow controls to be disregarded. The Corporation's procedures were insufficient to identify the general laxity in Focus' property services, although these procedures have since been revised to provide greater assurance about management controls in registered social landlords.
- regulators should handle allegations on a formal basis rather than rely on informal contact with the body concerned. The Corporation should have passed the allegations in full and in writing to the Association, demanded a formal response, and followed up to ensure that the allegations had been investigated. Planned guidance to registered social landlords and Corporation staff on how to deal with allegations should improve matters.
- when corruption like this occurs or is suspected, regulators should quickly ascertain whether the corruption goes wider than the case immediately under investigation. The Corporation took sensible steps to rule out the possibility of wider-scale corruption affecting other registered social landlords in the West Midlands.
- it is important to learn lessons from experiences such as the Focus case. The Corporation has carried out internal and independent reviews of its procedures and how they were applied, and intends to publicise the lessons learned now that the case is no longer sub judice.
- the Corporation does not operate a whistleblowing line that affords protection to informants from within registered social landlords. Nor do the external auditors of registered social landlords have a reporting responsibility to the Corporation on key aspects of compliance, unlike



their counterparts in some other sectors. The Corporation and the Department of the Environment, Transport and the Regions are considering whether these steps, if practicable, might help prevent and detect corruption and impropriety.

# Part 1: Introduction

## What this report is about

**1.1** In April 2000, three men were sentenced to prison terms for corruption in relation to the purchase of homes by Focus Housing Association (Focus) from a Birmingham property dealer. This report examines the Housing Corporation's (the Corporation) oversight of Focus before and after allegations of corruption surfaced in November 1995. It also examines the Corporation's action to discover the extent of the problem and prevent a reoccurrence.

## The corruption and overpayments at Focus

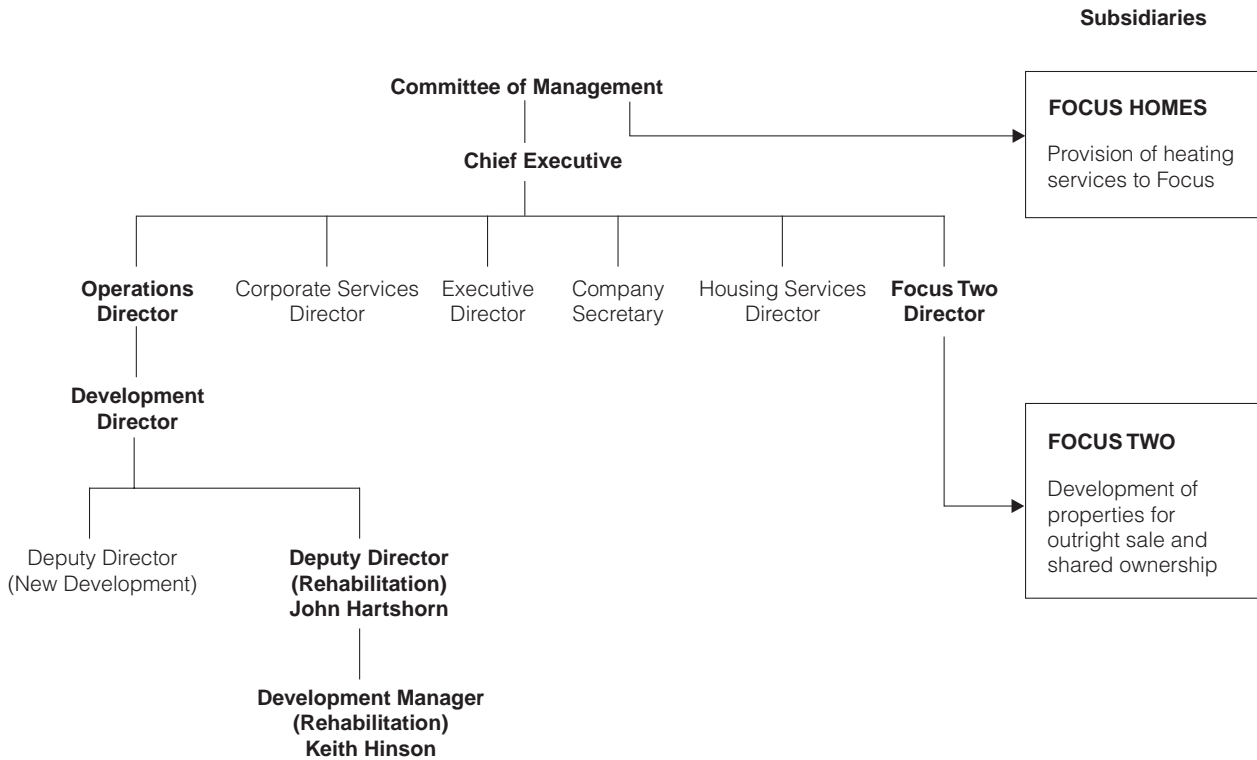
**1.2** Focus has been the largest housing association in the West Midlands since it was formed in October 1991 from the merger of St Chads Housing Society, Hestia Housing Association and Copec Housing Association. In 1995, when the corruption came to light, the Association owned over 11,000 properties valued at £384 million in Birmingham, Coventry and surrounding districts, and employed some 530 staff. Its main business was and still is to provide homes for rent. In 1991 it also established two subsidiary associations, Focus Two Housing Association Limited, which provides low cost homes for shared ownership, and Focus Homes Housing Association Limited, which provides heating services to the group (see Figure 1).

**1.3** In November 1995, Richard Clark, who took over as Chief Executive at Focus in April 1994, received anonymous allegations of serious fraud within the Association's property services department. The anonymous letters said that Focus employee, Keith Hinson, had accepted bribes from a property dealer, Darshan Ram, "to purchase houses, on behalf of Focus Housing, at a higher rate than is necessary". Mr Clark immediately informed the Housing Corporation and, after a short initial investigation, also passed on the allegations to the West Midlands Police in December 1995. Subsequent investigations by the Police and the Serious Fraud Office led to a criminal prosecution and trial at Birmingham Crown Court in early 2000 which resulted in Hinson, his manager Hartshorn and Ram being imprisoned for corruption (see Figure 2).

**Figure 1**

**How Focus Housing Association was organised between 1991 and 1995<sup>1</sup>**

*John Hartshorn and Keith Hinson held key positions within Focus' development function.*



Note: 1. In April 1995, Focus reorganised its development function; both Focus' and Focus Two's development activity was integrated within a single property services department under the leadership of the former Director of Focus Two.

Source: Focus Housing Association

**Corruption at Focus**

**Figure 2**

Between 1991 and 1995 Focus Housing Association bought at least 47 houses for £1.8 million from Darshan Ram, a Birmingham property dealer. These purchases were organised by Focus' deputy development director, John Hartshorn and his assistant, Keith Hinson. Over the period, Focus bought a further 95 rental properties from other property dealers.

Most of the properties Focus bought from Ram were back-to-back deals, that is Ram had himself purchased the properties on the open market only a day or two before selling them to Focus.

Ram paid Hartshorn and Hinson at least £5,450 and £16,300 respectively to reward them for the favourable treatment they showed him. In April 2000, Ram was sentenced at Birmingham Crown Court to 18 months imprisonment, Hartshorn was sentenced to 12 months and Hinson, 9 months.

**1.4** In December 1995, Focus asked its external auditors KPMG to investigate the anonymous allegations and, in particular, to determine whether Focus had paid too much for the properties bought from Ram and other property dealers. These investigations, based on valuations provided by the District Valuer, revealed a pattern of overpayments for properties bought from dealers by Focus and its subsidiary Focus Two, although only Ram made significant profits through back-to-back deals (see Figure 3). It is not possible to be precise about the extent of overpayment involved in these property transactions. Transactions involving dealers may be expected to include a premium reflecting the dealer's margin in return for bringing the properties to market. However, after allowing ten per cent as a dealer margin, we calculate that as a result of these failings, Focus and its tenants have borne the cost of unnecessary expenditure of at least £1.09 million, the sum overpaid for properties, and a further £467,000 spent on repairs which should not have been required. This is the best estimate of the overpayment by Focus, although the precise amount could range above or below this figure, because property valuation is not an exact science. Focus was also able to recover £250,000 of the overpayments from its insurers. The sums involved were small in relation to Focus' turnover and assets, and during this period the Association was nonetheless able to report trading surpluses.

## Overpayments at Focus

### Figure 3

Focus bought 142 properties from dealers between 1991 and 1995 and paid £741,200 more than the District Valuer's<sup>1</sup> assessment of their value, after allowing a margin for the dealer of 10 per cent. The average overpayment was around £5,200 or 19 per cent per property. Focus was able to recover £250,000 of this loss from its insurers.

Focus' subsidiary association, Focus Two, also overpaid property dealers, £344,850 for 81 properties, representing an average 18 per cent over the District Valuer's valuation.

Focus bought 96 properties which had been certified by an architect employed by Focus as 'satisfactory dwellings' but which were in such poor condition that an average of £5,000 needed to be spent on each (£467,000 in total) before they could be let. Proper approval for the expenditure was not obtained. Focus now believes that this was done, in part, to favour Ram but also to provide work for favoured contractors.

Note: 1. District Valuers are employed by the Valuation Office Agency, an executive agency of the Inland Revenue, to provide property valuation services to both the public and private sectors.

**1.5** It is not known if similar problems existed before Focus was formed in 1991 by the merger of three associations - KPMG investigated purchases made by Copeck Housing Association and found no problems, but it could not locate Hestia Housing Association's property records and thus could not obtain details of its property transactions. The investigations commissioned by Focus have not been able to establish fully why Focus used property dealers so frequently instead of other

sources of housing, such as local authorities or building societies. Focus bought 80 per cent of its housing for rent (excluding new developments) from dealers during a period when there was a housing market slump and properties were relatively plentiful and cheap. This practice was not uncommon in the West Midlands at that time, although it was far less common in other parts of the country.

**1.6** Each purchase by Focus or Focus Two was supported by a property valuation provided by an independent valuer commissioned by the Association. Three quarters of the valuations for Focus and Focus Two were provided by three valuers. Focus considered legal action to claim back some of its losses against one of these valuers who carried out around half of all the valuations on its properties bought from dealers and to whom the worst cases of overvaluation are attributed, but did not proceed mainly because this valuer had been declared bankrupt.

**1.7** A total of £2.4 million of public moneys were provided to Focus for the purchase and repair of the properties at Figure 3. In general, the Corporation's grants towards the purchase of housing for rent are based on the size and location of the property and are not linked directly to the property's purchase price. However, in the case of properties funded through the Housing Market Package (see paragraph 1.14), the Corporation provided a fixed proportion of the purchase price in grant. Focus bought 57 properties from property dealers under this arrangement, for which it paid £251,000 more than the District Valuer's valuation. In May 1997, the Corporation required Focus to pay back the grant element of the overpayment which was £198,000.

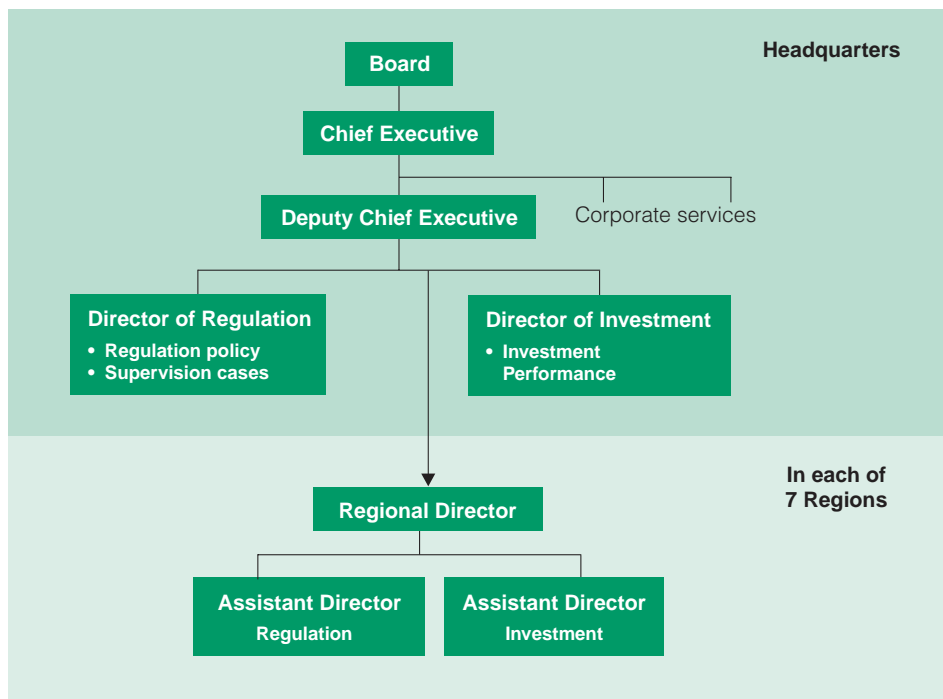
## **The Housing Corporation's role in relation to Focus**

**1.8** Focus Housing Association is one of 2,200 registered social landlords in England who together provide approximately 1.4 million homes for rent on a not-for-profit basis. The vast majority of registered social landlords are constituted as registered charities or industrial and provident societies. A small number are companies. The Housing Corporation both funds and regulates registered social landlords. It employs some 650 staff at its headquarters and seven regional offices (Figure 4) divided between "investment" staff working on the funding of landlords and regulatory staff. These staff come from a variety of backgrounds including some with expertise in building procurement.

**How the Housing Corporation is organised**

**Figure 4**

*The Housing Corporation divides its work between regulation and investment, at both headquarters and its seven regions.*



Source: Housing Corporation

Note: Some regions have a single deputy but retain separate regulation and investment teams.

**The Housing Corporation’s regulatory role**

**1.9** Registered social landlords’ governing bodies have the primary responsibility for the proper conduct and control of their affairs. In the case of industrial and provident societies, a management committee of appointed members is normally responsible for overseeing the work of the association’s officials. In the case of companies, this responsibility lies with the company’s board of directors.

**1.10** The Corporation’s regulatory role is to ensure that registered social landlords are effective in providing social housing and that the interests of tenants and taxpayers are properly safeguarded. The Corporation, a non-departmental public body sponsored by the Department of the Environment, Transport and the Regions, carries out its regulatory responsibilities within a framework of statutory powers which allow it to:

- register and de-register social landlords;

- draft statutory guidance and set regulations (known as Determinations) on key areas of activity of registered social landlords;
- scrutinise returns and accounts submitted by registered social landlords in compliance with the legislation, guidance and Determinations it has issued; and
- supervise registered social landlords where performance is unsatisfactory, including powers to intervene in cases of mismanagement or misconduct.

**1.11** The Corporation's regional offices, including the West Midlands regional office which oversaw Focus, have day-to-day responsibility for regulating registered social landlords. However, the Corporation's headquarters and Chief Executive are kept informed of any serious cases and of those where there is any significant threat to public funds.

**1.12** The Corporation's regulatory framework comprised three elements at the time of the events at Focus.

- Since 1989 the Corporation issued performance standards which set out its expectations as to how registered social landlords should conduct their affairs. The key standards applying between 1992 and 1995, the period relevant to this report, are set out in Appendix 1. In 1994 the Corporation introduced detailed benchmarks for its performance standards to promote common and consistent judgements by its performance review staff about the seriousness of lapses in landlords' procedures.
- In the period up to 1994 the Corporation carried out performance review visits to landlords on a cyclical basis to assess landlords' performance against the standards. A formal system of desk top reviews was introduced from 1994 onwards including visits to follow up potential concerns. The system of reviews is described more fully in Appendix 2.
- The Corporation could take or require remedial action if it found cause for concern over a landlord's performance. Such action might simply require improvements to landlords' procedures but may also extend to withdrawal of funding. In serious cases, where a statutory inquiry had

found mismanagement or misconduct, the Corporation could direct the transfer of a landlord's housing stock to another landlord with the Secretary of State's agreement.

Whilst this basic framework for the Corporation's regulation of registered social landlords has not changed since 1995, there have been significant changes to some of the elements. Those changes relevant to the Corporation's regulation of landlords' development activity, including property procurement and contracting arrangements, are discussed in Part 3.

**1.13** In April 1994 the Corporation's regulation of housing associations was the subject of a report by the Committee of Public Accounts (Financial Management of Housing Associations, HC204 1993-94). That report emphasised the need for the Corporation to pay particular attention to the quality and probity of associations' procurement methods and to give close attention to the risks of fraud and irregularity in associations (Appendix 3).

### **The Housing Corporation's funding role**

**1.14** Central government makes a number of different types of grant available to registered social landlords to support their activities. Capital grants are provided to associations for the purchase of homes for rent. Other grants support the provision of lowcost home ownership, and specialist accommodation and services for those with special needs. By 1999 registered social landlords had received some £22 billion in government grants disbursed by the Housing Corporation and through local authorities. The peak year for Corporation grant funding was 1992-93. In that year, a government initiative, the Housing Market Package, aimed at helping the housing market out of recession, made £580 million of additional money available to housing associations to spend between 12 November 1992 and 31 March 1993. 81 associations spent an extra £577 million over these 93 days, bringing the total Housing Corporation capital grant funding to £2.3 billion for the year. Since then capital grant funding has declined; in 1999-00 it was £660 million with a further £330 million funded by local authority social housing grant.

**1.15** Over the period covered by our investigation, Focus was the largest recipient of Housing Corporation grant in the West Midlands. Between 1991 and 1996 Focus received grants totalling £104 million to help meet the costs of its development programme totalling £206 million. Focus was a major recipient of Housing Market Package funding, receiving £15.5 million with which it purchased



577 empty houses and flats, mainly from builders and building societies although 57 were purchased through dealers. The corruption and overpayments at Focus affected only a small proportion of these sums.

**1.16** Registered social landlords can apply for grant funding from the Corporation for a number of different types of property investment, for example new build schemes, conversions or rehabilitations, and “existing satisfactory dwellings”. Landlords apply for grant up to a specified proportion of a property’s total cost, subject to the Corporation’s cost limits for that property’s type, size and location. The Corporation also requires landlords to obtain an independent valuation report to support all land and property purchases. Since 1991, registered social landlords have been able to call on valuations carried out by the District Valuer’s Office (now the Valuation Office Agency) or any other independent qualified valuer.

**1.17** During the period covered by this report the Corporation undertook ‘scheme audits’, on a sample basis, of landlords’ development projects which received grant support. These audits, carried out by specialist investment staff, checked whether grant-funded developments met the Corporation’s cost limits and technical standards for social housing. As part of this work, scheme audits reviewed the contract arrangements made for the scheme including whether an independent valuation report had been obtained.

## Scope and methods

**1.18** We examined the Corporation’s regulation of Focus from the Association’s formation in 1991 to 1998, when the Serious Fraud Office decided to instigate criminal proceedings. We reviewed files held by the Housing Corporation at its headquarters and at its West Midlands regional office, and files held at Focus. We also interviewed relevant staff at Focus and the Corporation’s headquarters and received information from former staff from the Corporation’s West Midlands regional office. Now that the prosecution has been brought to a close, the matters central to this report are no longer sub judice and we are able to report our findings:

- In Part 2 of the report we look at whether the Corporation did enough to detect and act on the weaknesses at Focus prior to being notified of the fraud allegations, and whether the Corporation took appropriate action after being notified.

- In Part 3 we examine the wider implications of the Focus case, in particular what the Corporation did to determine whether Focus was an isolated case and the steps it took to prevent a reoccurrence of the type of property fraud and mismanagement which occurred at Focus.

## Part 2: Oversight of Focus

### Focus Housing Association

**2.1** The corruption and overpayments took place against a background of poor control over property developments at the Association. Subsequent investigations commissioned by Focus in early 1996 and undertaken by the consultants HACAS identified long-standing weaknesses in the development procedures operated by the Association's property services department. In January 1996 HACAS reported:

- “With exceptions, the Association does not have a formal system of approved, up-to-date and written development procedures setting out the standard of management required and the appropriate levels of delegated authority at which decisions may be taken. A thorough overhaul of development procedures should be undertaken ... .”;
- “As well as a lack of detailed procedures, the Association lacks a culture in which project management is subject to a system of routine checking for compliance with standing orders, development procedures and funding authorities' requirements. ... In particular, the systems in use for checking propriety in the selection of contractors and technical consultants lack rigour.”

**2.2** In a further report in April 1996, HACAS concluded that the management culture prevailing up to 1994 could be summarised as “development expansion as the Association's primary goal, applied on the basis that the end justified the means”. They identified:

- “a general disregard for policies, procedures, controls and the standard ways of working that they imply”; and that
- “staff had been allowed (if not encouraged) to have a very close relationship with developers and contractors”.

HACAS also concluded that internal audit at Focus had been weak, and that corruption of the sort that took place at Focus would be unlikely to be detected by the normal process of external audit.

**2.3** The arrival of a new Chief Executive, Richard Clark, in April 1994 marked the beginning of a period of change. Over the following year new staff were brought into the Association's senior management team. Other changes of key staff were also made.

**2.4** HACAS' work did not directly address the Corporation's oversight of the Association during this period; the principal responsibility for ensuring proper procedures and controls rests with the Association's governing body and management. Nonetheless, HACAS' findings do raise the question of whether the Corporation did enough to identify and remedy weaknesses in the Association's management before the Chief Executive informed them of the allegations in November 1995. To answer this question, in the sections that follow we look first at the results of the Corporation's routine reviews of Focus before November 1995, and then at the action taken in response to information it received about possible dishonesty by Hartshorn and overpayments on purchases from property dealers.

## **Action taken by the Corporation prior to being notified of the fraud in November 1995**

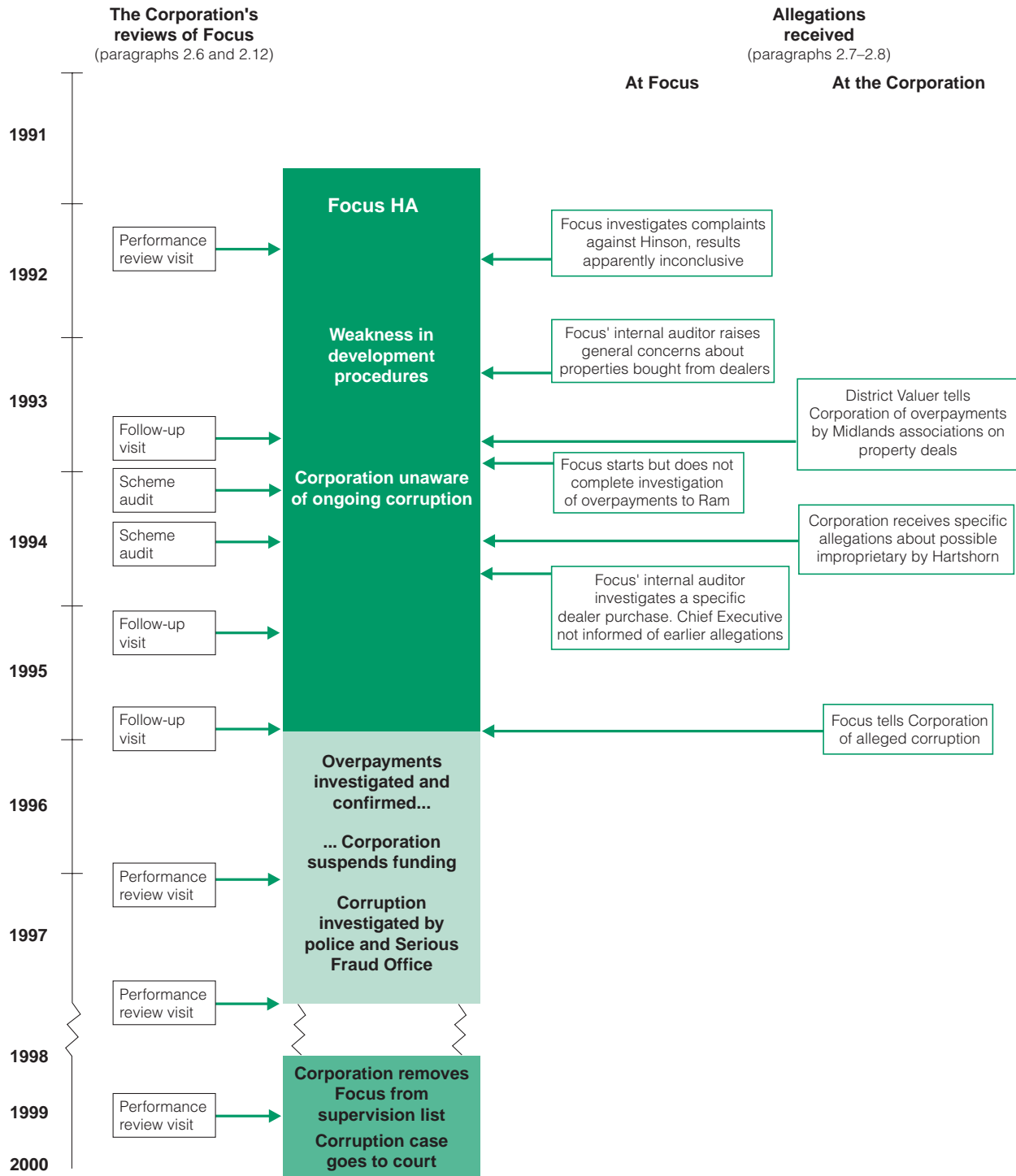
**2.5** Figure 5 sets out the main sequence of events from 1991 to the present day. In the four years before the corruption was reported to the Corporation, in November 1995, Focus was subject to several routine reviews by the Corporation (shown on the left hand side of Figure 5). In addition, the Corporation received allegations relating to the conduct of Hartshorn. The Association had also had its own suspicions about the conduct of both Hartshorn and Hinson (shown on the right hand side of Figure 5). In the following sections, we first look at the outcome of the Corporation's routine reviews, and then at the way in which the various allegations and suspicions were dealt with.

### **Corporation reviews of Focus prior to November 1995**

**2.6** Staff from the Corporation's West Midlands office carried out performance review visits to Focus in 1992, 1993 and 1995 and two scheme audits of a sample of Focus' housing developments in 1994. The Corporation assessed the Association's performance as "satisfactory" until its review in February 1995. Although the Corporation did identify concerns with some aspects of the Association's development activity, it did not identify the scope for corruption and irregularity in the property services department or the lax management and culture which HACAS later identified in 1996 (see paragraphs 2.1 - 2.2).

**Figure 5**

**Chronology of events**



Source: National Audit Office

- In May 1992, the Corporation's first performance review visit assessed Focus' performance overall and that of the development function as "satisfactory". However, it urged Focus to establish clearly documented procedural guidance for its development projects and introduce controls for double-checking decisions.
- In September 1993, a follow-up visit looked at those areas of performance which had failed to fully meet the Corporation's standards in 1992. As a result, it did not look in detail at the development function.
- In January 1994 the Corporation carried out a scheme audit of seven property purchases funded by the Housing Market Package (see paragraph 1.14). The audit found that in two cases the independent valuer had been asked to provide a valuation at the figure already agreed between the Association and the vendor, although this was not unusual. It also found several minor procedural errors, for example in the completion of grant claims. In concluding that the Association's development performance was broadly satisfactory, the Corporation officer noted that he had taken into account the speed needed to qualify for funding under the Housing Market Package. The shortcomings raised by the audit were resolved in correspondence with Focus.
- A June 1994 audit of 11 development schemes assessed the Association's performance as satisfactory but identified weaknesses including failure to obtain independent reports on tenders; failure to tender for consultancies; and contracts with no documentation to justify the choice of contractor. The Corporation obtained satisfactory explanations, or pledges to improve procedures, in response to these findings.
- In November 1994, a desk top review of Focus' performance did not identify any concerns relevant to Focus' development function, with the exception of concerns over the propriety of the purchase, in March 1994, of eighteen residential units for the elderly in a thirty unit development known as Brentwood Gardens. Focus' new Chief Executive had informed the Corporation in October 1994 that he had appointed consultants, HACAS, to investigate the propriety of this transaction. The purchase did not receive grant from the Corporation. HACAS reported in November 1994 that Focus had paid £268,000 more than HACAS' estimate of the probable market value at the time of £388,000. The purchase had been rushed through without the approval of Focus'

Committee. As a result of this report, the Corporation flagged up potential serious concerns about Focus' Committee, management and financial controls and decided to visit Focus to pursue these concerns.

- In February 1995, the follow-up visit to examine the weaknesses identified by the desk top review took place. Although the development function was not the prime focus of the visit, the review team found that the Association had not followed its own rules for authorising negotiated tenders. The negotiated tenders register had not been signed since 1990, despite Focus having agreed contracts worth £23 million on a negotiated rather than tendered basis over the intervening period. The Corporation did not judge this as a matter for serious concern, as remedial action was being taken by the Association; and impropriety in the letting of contracts was not suspected. Nonetheless, as a result of issues raised by the Brentwood Gardens case, in March 1995 the Corporation assessed Focus as a supervision case meriting extra attention.
  
- In November 1995, before the Association reported the suspected corruption, a further visit to Focus concentrated on Focus' response to earlier Corporation recommendations and did not examine the development function, except to confirm that the negotiated tenders register was now being signed in accordance with Focus' procedures.

### **Allegations received before November 1995**

**2.7** In addition to the findings from these routine reviews by the Corporation, more specific suspicions and allegations about corruption in Focus had been raised by various parties in the years prior to November 1995. Neither the Corporation nor, in the later stages, the new Chief Executive at Focus possessed a full history of the allegations. Between 1992 and 1995 there were four warnings about either Hartshorn or Hinson which were the subject of internal investigations within Focus but of which the Corporation were unaware (see Figure 6). None of the allegations were passed on to the Corporation; a new requirement issued in 1993 obliged associations to notify the Corporation immediately in cases where there was evidence of detected or attempted fraud.

## Indications of possible fraud known to Focus

### Figure 6

- In May 1992, Focus received a complaint that Hinson was favouring particular contractors; a senior manager investigated the complaint but found no evidence of corruption.
- In April 1993, Focus' internal auditor questioned the purchase of 30 properties bought as part of the Housing Market Package from a property dealer. Focus' senior managers discussed the possibility that Ram was offering financial inducements to Hartshorn and Hinson in return for higher prices but concluded that this was highly unlikely. A checking system on acquisitions was introduced.
- In November 1993, a Focus manager was informed that Focus was still purchasing numerous properties from Ram. An investigation was started but not completed, and Hartshorn and Hinson were instructed not to acquire any more properties from Ram and his associates without authorisation from senior managers.
- In August 1994 Focus' internal auditor raised concerns that the purchase of a property by Hartshorn from another dealer had involved impropriety. Although an investigation by the Operations Director cleared the purchase, the new Chief Executive of Focus issued an instruction that no further properties should be purchased from dealers. The Chief Executive, who had taken up post in April, was not informed of the earlier suspicions and allegations. Hartshorn and Hinson continued to purchase properties from dealers.

**2.8** In addition, in 1993 and 1994 the Corporation received information relating to possible overpayments and impropriety at Focus:

- In November 1993, the Regional Director of the Corporation's West Midlands office met the region's Chief District Valuer to discuss concerns which had arisen within the Valuer's office over the prices paid on land and property deals by some registered social landlords. This meeting was not minuted and we cannot be certain about all that was said. A former member of the Corporation's West Midlands office who attended the meeting told us that the District Valuer said there were certain landlords which regularly struck deals with the same vendors, paying very inflated prices for land or property, but that due to confidentiality rules the District Valuer could not give the Corporation information which would allow it to identify specific landlords or dealers. We were unable to corroborate this version of events or establish what action the Corporation's regional office took next, because the Corporation has not been able to trace any internal note of the meeting or note of any follow up action.
- In June 1994, an officer at the Corporation's West Midlands office heard rumours from two different sources that Hartshorn may have had an improper financial relationship with a contractor and a structural engineer. The officer reported the detail of the allegations to the Director of Registration and Supervision at Corporation headquarters and was



asked to refer the matter to the Chief Executive of Focus. She did not report the allegations to her immediate superiors. The officer did not inform the Association in writing or ask Focus to investigate the allegations, nor did she tell the Association that Hartshorn had left a previous association under suspicion of similar impropriety. The officer did, however, warn Focus' new Chief Executive, Richard Clark, to keep an eye on Hartshorn as he might be dishonest. The Chief Executive discussed Hartshorn with his Operations Director, who assured him that Hartshorn was honest. In the light of this assurance, and the non-specific nature of the information given to him, Mr Clark did not take the matter further. Subsequent investigations have found no evidence that the contractor and engineer named in the allegations had any improper financial relationship with Hartshorn. At the time of its next review visit in February 1995 the Corporation did not follow up to see if and how these allegations had been resolved.

More vigorous action by the Corporation in response to the 1994 allegation could have resulted in closer attention being paid to Focus' development function, and this in turn might have led to the corruption and overpayments being discovered earlier (see paragraph 3.9).

## **Action taken after the allegations of fraud were received in November 1995**

**2.9** In November 1995, when the Corporation was notified by Focus' Chief Executive of the allegations of fraud he had received, the Corporation took the following action in relation to Focus:

- immediately suspended funding of Focus;
- supervised the affairs of the Association closely, convening frequent meetings of senior Corporation staff to monitor progress and ensure that the scope of the investigations commissioned by Focus was adequate;
- nominated two members for appointment to Focus' Management Committee; and
- imposed conditions on Focus before approving the release of any further public funding.

**2.10** Following investigations undertaken in the months after November 1995, Focus dismissed Hartshorn and Hinson in April 1996 and their senior manager resigned. In October 1998, Hartshorn, Hinson and Ram were charged with 24 counts of corruption. Hinson admitted the offences whilst Hartshorn and Ram changed their pleas to guilty during the trial in February 2000. One charge was dismissed and one charge relating to payments to Hartshorn was allowed to stay on file. Hinson admitted receiving £16,300 from Ram and Hartshorn admitted receiving £5,450 in order to give preferential treatment to Ram by buying properties from him on behalf of Focus Housing Association. In April 2000, at Birmingham Crown Court, Ram was sentenced to 18 months imprisonment, Hartshorn was sentenced to 12 months and Hinson received a 9 month term.

**2.11** In June 1996 the Corporation resumed funding for Focus, after satisfying itself that proper internal controls were in place and were being operated. In the meantime, the Corporation reviewed the grant paid on all Focus schemes involving purchases from property dealers, with a view to recovering any over-claimed grant. In May 1997, Focus agreed to repay grants totalling £198,000 which it had received as a result of the overvaluation of properties bought through the Housing Market Package (see paragraph 1.7).

**2.12** In January 1998, Focus was removed from the Corporation's supervision list following satisfactory performance reviews in January and November 1997. The Corporation's latest visit, carried out in March 1999, concluded that Focus met all the Corporation's performance standards.

## Focus today

**2.13** Since Focus' discovery of the corruption in its Property Services Department, the Association has worked hard to remedy its failings. The Property Services Department has been comprehensively restructured; all seven senior managers were replaced by staff new to the organisation, including a new director. Focus introduced new procedures to cover all aspects of its development function and subsequently undertook extensive audits to ensure that its new systems were being operated and worked effectively. In addition, a comprehensive Code of Conduct for employees was drawn up and hospitality received by employees is now checked rigorously. Other changes introduced give the Focus Committee better management control over the organisation.

## Part 3: Wider implications of the Focus case

**3.1** Part 2 of the report dealt with the Housing Corporation's regulation of Focus Housing Association before and since the discovery of the corruption and overpayments on property transactions in 1995. This Part deals with the broader issues arising from the events at Focus.

### Action to discover whether other registered social landlords were involved in corrupt property deals

**3.2** When the Corporation received information in November 1995 which suggested that criminal activity may have taken place in relation to the purchase of properties by Focus, it immediately suspended new funding to all registered social landlords in the Birmingham area whilst it investigated whether the corruption went beyond Focus. At the request of West Midlands Police, who were concerned about the legal implications of making public the nature of the corruption, the Corporation did not alert other registered social landlords to the Focus case or the temporary suspension of new funding.

**3.3** The Corporation's Chief Executive approached the Chief Executive of the Valuation Office Agency, which receives details of all freehold property transactions and asked the Agency for information on:

- whether other registered social landlords in the West Midlands had bought property in back-to-back deals; and
- whether other landlords had purchased property from Ram and his nominees.

The Valuation Office Agency refused to disclose the information the Corporation requested because the information was protected by confidentiality rules designed to facilitate the collection of tax.

**3.4** In January 1996, therefore, the Corporation asked those registered social landlords in the West Midlands that had received a regular programme of funding for development to direct their solicitors to furnish details of any back-to-back purchases. Most landlords were able to report no transactions which raised suspicions but some did not have the information available. In March 1996, the

Corporation asked the six landlords whose solicitors could not provide information on back-to-back deals for copies of their Seal Registers, an internal document providing a record of all of a landlords' property transactions. In three cases, the records did not raise any suspicions and in the other three cases the results were inconclusive because the vendor details were not recorded.

**3.5** Thus the Corporation was able to obtain data for nearly all of the registered social landlords thought to be at risk, and did not find any evidence to suggest a history or pattern of back-to-back purchases, or of purchases from Ram or one of his nominees. As a result, the Corporation decided not to conduct similar investigations throughout the country. No similar cases of corruption have come to light in the West Midlands since the Focus case.

## **The Corporation's assessment of its own role**

**3.6** Following the emergence of the corruption and overpayments at Focus, the Corporation undertook two investigations, in January and April 1996, of the way it had regulated Focus. It considered:

- whether its performance reviews and scheme audits of Focus had been carried out in accordance with its normal procedures, including the follow-up action taken;
- whether it had dealt correctly with the specific allegations about Focus it received in June 1994; and
- the effectiveness and suitability of its performance review and scheme audit systems.

**3.7** The Corporation concluded that its review and audit procedures had, on the whole, been followed correctly. It identified two weaknesses:

- the Corporation should have followed up Focus' failure to maintain a proper negotiated tender register, which it identified in February 1995; and
- the concerns raised by Focus' internal auditor about property valuations (Figure 6) should probably have been identified had the performance review visits looked at the arrangements for handling internal audit findings.

The Corporation changed its regulatory approach in the light of the investigations' findings (see paragraphs 3.11 to 3.13). The investigations, however, did not identify that the Corporation had also not followed up its 1992 finding that Focus lacked documented procedural guidance for its development projects or internal controls to double-check property decisions (see paragraph 2.6, 1st bullet).

**3.8** On whether it had dealt correctly with the allegations it received in June 1994 of possible impropriety by Hartshorn (see paragraph 2.8), the Corporation concluded that it had not. It identified a number of errors in the way it handled the allegations, which it subscribed to human error rather than a fault in its procedures:

- the Corporation's Director of Registration and Supervision at headquarters should have ensured that the allegations were followed up properly, including requiring a response from Focus; and
- other senior colleagues at Corporation headquarters and the regional office should have been informed of the allegations.

**3.9** Whilst the Corporation acknowledges these weaknesses, it believes that an investigation would have been unlikely to have uncovered directly the relationship between Hartshorn and Ram and the back-to-back property deals, because the allegations incorrectly identified an engineering contractor and a builder as the supposed parties to Hartshorn's corruption, rather than a property dealer. However, any detailed examination of Hartshorn's role and work for the Association, especially any review of the pattern of purchases and the prices paid to dealers, may have uncovered the overpayments on back-to-back property deals, particularly as suspicions about his activities had been raised previously (see Figure 6).

**3.10** The Corporation's investigations also looked at the effectiveness and suitability of its performance reviews and scheme audits. The Corporation considered that it was a matter of concern that its routine reviews had not picked up the failure of internal controls at Focus. The Corporation identified that its performance reviews were reliant on self-certification by landlords; thus, whilst they might identify whether control systems and procedures were absent, they were unlikely to identify whether procedures were being operated properly. The Corporation also concluded that its audits of a sample of development schemes would have been unlikely to detect the corruption at Focus, given the collusion between the various parties and because the properties bought from dealers

represented only five per cent, by cost, of Focus' total development programme for rent over a five year period. The Corporation revised its procedures in the light of these findings and this is covered in the next section.

## **What the Corporation has done to prevent a repetition of the Focus case**

**3.11** As a result of its investigations, the Corporation decided to examine whether changes to its procedures were necessary to ensure that it could be satisfied that major developing landlords have effective systems of internal controls. In early 1997, it carried out a pilot study into the regulation of development work in registered social landlords. This study identified a number of inadequacies with the Corporation's approach and made nine recommendations for change, the principal ones being:

- to make the questions asked of landlords on the annual return more informative and searching;
- to make the regulation of development work more risk-related, for example in the selection of schemes to audit; and
- to better co-ordinate performance review work and scheme audits to ensure that the systems controls identified by performance review visits are properly tested in operation.

**3.12** Following the pilot study, in 1998 the Corporation reorganised the way in which it regulated landlords' development and maintenance activity to address the weaknesses it had identified. It introduced a new series of development and maintenance visits carried out jointly by its regulatory and technical staff. These involve additional checks to ensure that internal controls over landlords' development activities operate as they should. The Corporation also changed the way it selected schemes for audit from a random approach to one based on risk. This new system has also led to new reporting requirements of landlords which, in August 1998, were incorporated into Performance and Scheme Development Standards.

**3.13** The Corporation has made a number of other changes to its regulatory systems since 1995 as part of its continuing efforts to improve the effectiveness of its regulation. These are not aimed specifically at property deals or other contracts, but overall should enhance the effectiveness of the Corporation's regulation.

- Since March 1996 the Corporation has required that each registered social landlord's financial statements include a statement about its systems of internal financial control. The landlord's external auditors are now required to review this statement and to report in accordance with the requirements of professional standards on the audit of corporate governance. More recently, the Corporation has sought powers which would allow it to call on external auditors of registered social landlords to report on key aspects of regulatory compliance; the Department of the Environment, Transport and the Regions is considering this issue as part of its current quinquennial review of the Corporation.
- In 1997 the Corporation developed a new approach to its quality assurance of regulatory work, designed to focus more on risk areas and concentrate on the evidential basis for judgements made and decisions reached.
- Since 1997 the Corporation's performance standards have required registered social landlords to adopt procedures which would enable staff to raise confidentially any concerns about propriety with the governing body or a person delegated by the governing body. However, staff who report their concerns to the Corporation are not afforded the protection of the Public Interest Disclosure Act 1998, because the Corporation was not included in the list of bodies designated under the Act. The Corporation has suggested that it should be so designated, and the Department is considering this point as part of its current quinquennial review of the Corporation.
- In April 1998 the Corporation introduced a requirement for all registered social landlords to complete an annual return that, for larger landlords, includes a self-assessment signed by the Association's Committee of Management, of the extent to which the landlord meets the Corporation's Performance Standards.
- Also in 1998, the Corporation introduced a 'lead regulator' role in which more senior regulatory staff are expected to develop a closer contact with the largest registered social landlords, to gain a better understanding of their business and culture, and their management of risk. This has been further developed by the formation of a central lead regulation unit in 1999 staffed by a number of senior employees of major associations on secondment to the Corporation.

The Corporation has also used the events at Focus in its staff training, as a case study for the identification, investigation and management of such cases.

## **What the Corporation has done to disseminate lessons learned from Focus**

**3.14** In addition to the changes that the Corporation has made to its own regulatory systems, it has also wished to promulgate some of the lessons learned from the Focus case to registered social landlords generally. In 1998, it published a review “Learning from Problem Cases” produced on its behalf by HACAS. The Focus case was amongst those reviewed but could not be included in the final report because the case was still sub judice at the time of publication. However the Corporation intends to include the case in its next publication of this type.

**3.15** The Corporation is currently developing guidance for registered social landlords containing advice on back-to-back property deals, which is due to be sent to all landlords later in 2000. In addition, HACAS, on behalf of the Corporation, is producing guidance for registered social landlords on how to handle fraud and other allegations. The Corporation intends to update existing guidance for its own staff based on the work done by HACAS.



# Appendix 1

## The Housing Corporation's performance standards

Since 1989 all registered social landlords have been expected to meet minimum performance standards issued by the Corporation. These were first issued in 1989 and amended in 1992 as part of a general move towards a more strategic, less “hands-on” relationship with landlords. The standards were amended again in 1995, 1997 and 1998. Extracts from the performance standards published in 1992, and therefore relevant to the period during which the fraud was taking place, are shown in the table below.

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### The Housing Corporation's Performance Standards for housing associations 1992-95

Category	Examples of Performance Standards
<i>Committee and management control</i>	<ul style="list-style-type: none"> <li>■ have a suitably skilled and representative Committee which controls, plans and oversees all aspects of the association's work in an effective and reasonable way;</li> <li>■ act within the association's constitution and comply with all relevant legislation, Corporation standards and requirements; and</li> <li>■ conduct their business to the highest standards of probity.</li> </ul>
<i>Financial management</i>	<ul style="list-style-type: none"> <li>■ operate financial systems which give the associations effective control of their financial affairs; and</li> <li>■ take a prudent approach to managing the financial risks faced.</li> </ul>
<i>Access to housing</i>	<ul style="list-style-type: none"> <li>■ have open and fair lettings policies which give priority to applicants according to the severity of their housing need; and</li> <li>■ co-operate with local authorities and other organisations to meet housing need.</li> </ul>
<i>Housing management</i>	<ul style="list-style-type: none"> <li>■ ensure that housing services are delivered fairly and without discrimination; and</li> <li>■ charge affordable rents in accordance with the law and guidance issued by the Corporation known as the Tenants Guarantee.</li> </ul>
<i>Property maintenance</i>	<ul style="list-style-type: none"> <li>■ plan for future maintenance and re-improvement of their housing stock in order to keep their properties in lettable condition.</li> </ul>
<i>Development</i>	<ul style="list-style-type: none"> <li>■ produce homes to a high standard of design, capable of easy maintenance and economical operation;</li> <li>■ set development strategies which respond to housing needs in their areas of operation; and</li> <li>■ ensure that they manage development risk and that their development programme is managed efficiently and to a high standard.</li> </ul>

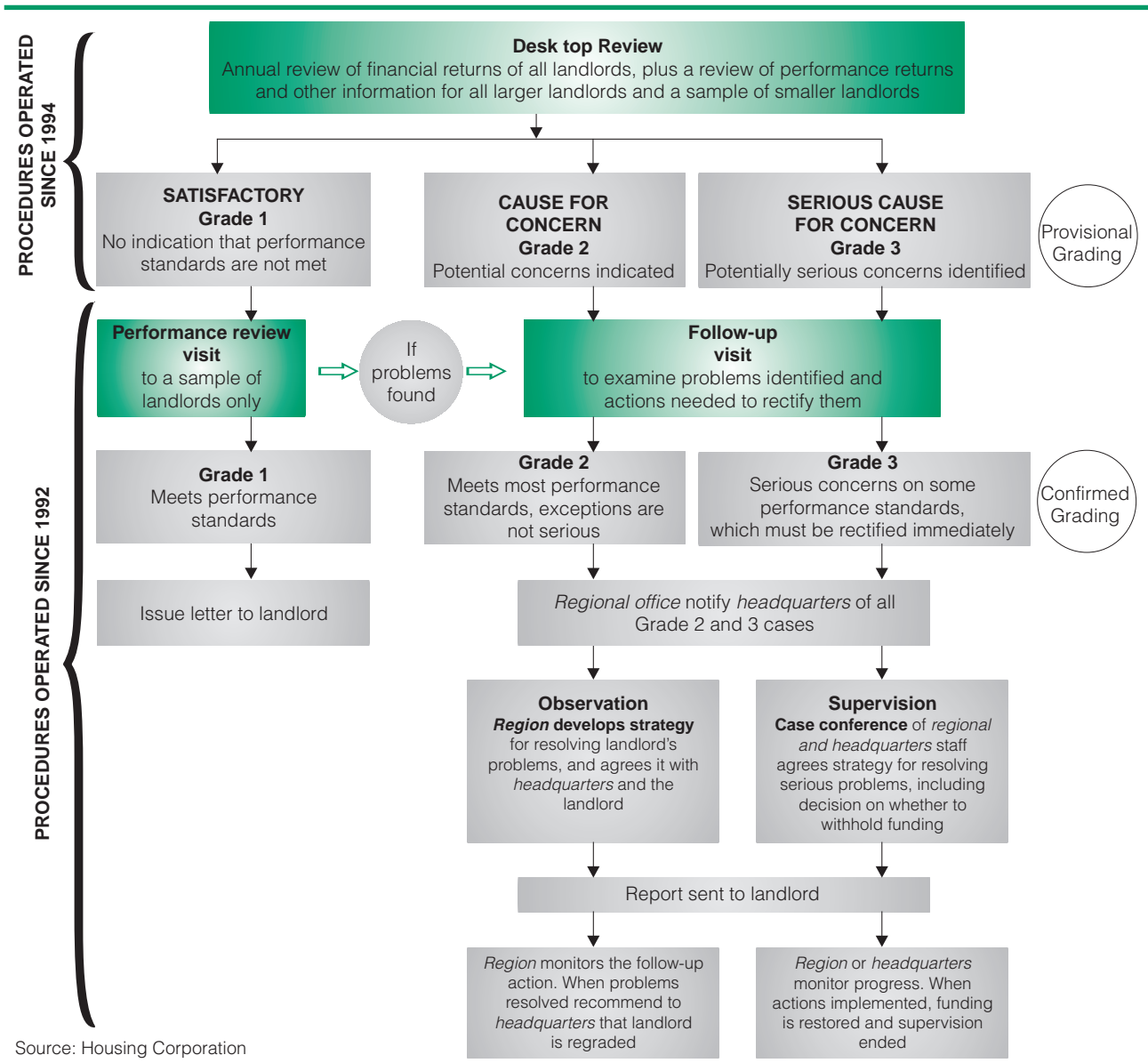
Source: Housing Corporation

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# Appendix 2

## The Corporation's performance review system

In the period up to 1994 the Corporation carried out performance review visits on a cyclical basis determined on the size and likely risks faced by landlords. A formal system of desk top reviews was introduced from 1994 onwards involving a scrutiny of information and returns provided to the Corporation on a regular basis. Visits to landlords were made to follow up potential concerns. An outline of the Corporation's performance review procedures during the events at Focus is shown in the Figure below.



Source: Housing Corporation

- Formal desk top reviews were introduced by the Corporation in 1994. Prior to that time the Corporation reviewed the annual accounts and auditors' letters to management and, from 1992/93 quarterly financial returns it received from larger landlords, but visits were determined primarily on a cyclical basis. Desk top reviews involve an analysis of a wider range of documents, including the the results of the region's assessments of development performance and returns from local authorities and tenant organisations. Since 1998, the Corporation has also required larger landlords to assess the extent to which the landlord has met the the Corporation's Performance Standards and each year, each region undertakes a sample of visits to landlords to validate the information sent to it.
- Performance review visits examine a landlords's performance against each of the Corporation's performance categories. The frequency of these visits reflect the region's assessment of the landlord's competence and the level of funding and assets at risk. On average a large landlord can expect a visit every 3 years and a small landlord will be visited every 10 years.
- Each review process results in a grade or score for different aspects of a landlord's activities, and an overall grading. While a landlord may fail to meet a particular standard this may still result in an overall grading of 'satisfactory' if the failure is minor and judged to be not material.
- Before 1998 regions also carried out periodic audits, called scheme audits, of development projects for which landlords received grants from the Corporation. A sample of the new housing schemes being developed in each landlord was examined to assess whether the Corporation's standards for quality of housing and probity of procurement were met. In 1998 the Corporation changed the way it regulated landlords' development and maintenance activity. It introduced a new series of development and maintenance visits carried out jointly by its regulatory and technical staff. These involve additional checks to ensure that internal controls over landlords' development activities operate as they should. The Corporation also changed the way it selected schemes for audit from a random approach to one based on risk. This new system has also led to new reporting requirements of landlords which, in August 1998 were incorporated into Performance and Scheme Development Standards.

- The results from a region's Performance Review system, together with the latest available information on each landlord's financial position, its ability to use its grant allocation whilst controlling costs, and the results from the scheme audits are considered by regional directors when deciding on landlords' suitability for public funding.

## Appendix 3

### Committee of Public Accounts' recommendations on the financial management of housing associations, and the government's response

In April 1994 the Committee of Public Accounts made 19 recommendations on the Comptroller and Auditor General's report on the Financial Management of Housing Associations. Extracts from the recommendations relevant to this report are shown below. At the time of the government's response, in 1994, oversight of the Housing Corporation was the responsibility of the then Department of the Environment (DOE).

<b>Committee of Public Accounts recommendations</b> (20th Report 1993-94, HC 204) Published 18 April 1994	<b>Treasury Minute response</b> (Cm 2602, 1993-94) Published 29 June 1994
(i) A large number of associations are still performing unsatisfactorily. The Corporation should closely examine the reasons... and the length of time over which problems have remained, and they should be prepared if necessary to withhold further allocations of funds.	The Corporation takes seriously all cases where performance... is... below the standards... The action plans agreed are monitored closely with associations and any delays in implementing changes are viewed seriously... The withholding of further allocations of funds is considered in all cases where there are causes for serious concern...
(ii) ... the Corporation's inspection visits to associations have fallen behind their planned cycle, and under their new programme some small and medium size associations may not be visited sufficiently frequently. We recommend that the Corporation look again at the frequency of their coverage, paying particular attention to the risk of fraud and irregularity and the need to ensure the proper conduct of public business.	The Corporation recognises the need to safeguard against the risk of fraud and irregularity within... associations. The new Performance Standards require all committees of management to satisfy themselves that they have proper systems of internal control and that their operation and effectiveness is reviewed regularly. ... compliance with this requirement must be demonstrated in the information submitted... in the Performance Standards Return. Any concerns arising from analysis of the Return, or of other information available to the Corporation, would result in an investigatory visit...
(iii) We emphasise the importance of the Corporation's scrutiny of new development schemes, and the need to pay particular attention to the quality and probity of procurement methods. Generally, given previous assurance to this Committee, we now look for firm and vigorous action by the Corporation to continue to improve their systems and procedures for effective regulation.	The Corporation recognises the need to keep its revised and enhanced system of scheme audit under review and updated where necessary. The system is important in monitoring the quality and probity of procurement methods employed by associations ...
(iv) We are disturbed at the serious fraud committed at Circle 33 Housing Trust, particularly as it had gone on for over seven years without being detected. ... Both the Corporation and the Department should continue to give close attention to the risks of fraud and irregularity in associations and to pursue promptly and vigorously any cases which arise.	... DOE accepts the need for close attention to be paid to the risks of fraud and irregularity. The Corporation's advice... places... on committees of management and their external auditors the responsibility to ensure these risks are minimised by effective internal controls. The Corporation, when advised of any fraud or irregularity within associations takes immediate steps to ensure that any underlying weaknesses are addressed. It is quite prepared to suspend allocations... and, where the circumstances demand it, to institute statutory supervision.

**Committee of Public Accounts recommendations  
(20th Report 1993-94, HC 204)  
Published 18 April 1994**

v) We attach great importance to the safeguards the Corporation's regulatory framework provides for the proper conduct of business within associations and ensuring value for money. We look to the Department to ensure that the Corporation's statutory powers are developed.

**Treasury Minute response  
(Cm 2602, 1993-94)  
Published 29 June 1994**

The Corporation already has wide-ranging powers under the Housing Associations Act 1985... to take action against an association where it considers there has been mismanagement or misconduct. The Corporation has identified some aspects of the regime which it considers could be improved to make it easier to take supervisory action in some circumstances and to obtain... information about the unregistered subsidiaries of registered associations... The Corporation will be consulting on its proposals, in order to inform decisions on possible statutory changes...