Regulating housing associations' management of financial risk

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 399 Session 2000-2001: 19 April 2001

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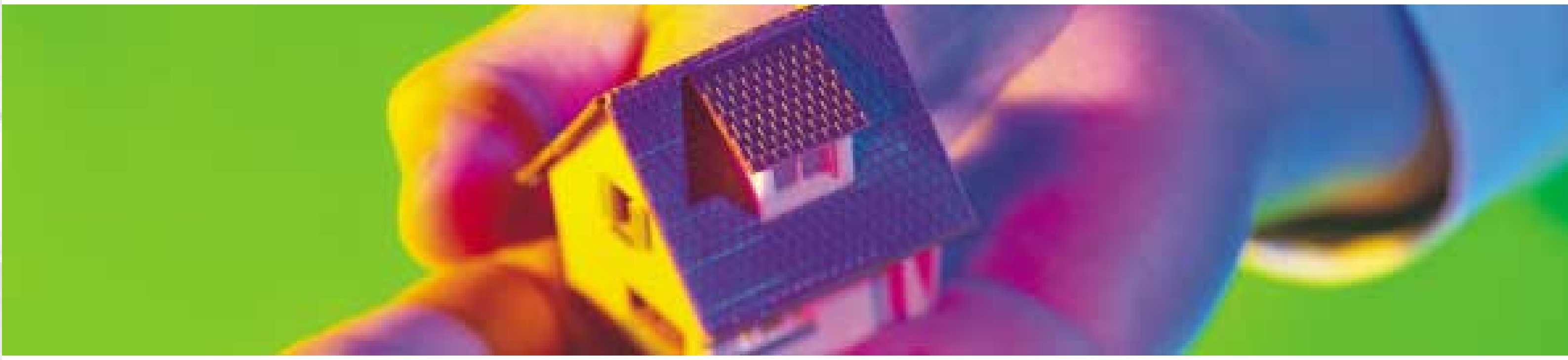

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John Bourn
Comptroller and Auditor General

National Audit Office
2 April 2001

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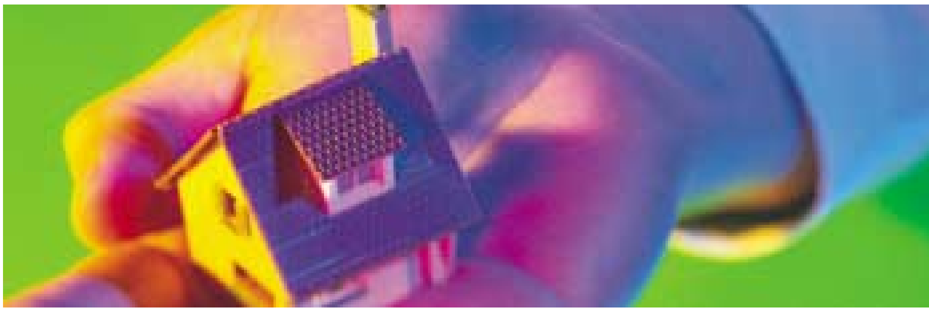
executive summary

Background and main findings

1 The Housing Corporation (the Corporation) is a non-departmental public body sponsored by the Department of the Environment, Transport and the Regions (the Department). The Corporation has two main functions - paying grants to housing associations and other registered social landlords[1] (RSLs) to provide social housing; and regulating RSLs' governance, financial performance and their development and provision of social housing in order to protect the interests of tenants and taxpayers. This report focuses on the Corporation's regulation of RSLs' financial performance, and particularly their management of financial risk.



2 RSLs are either registered charities, industrial and provident societies or companies registered with the Corporation to provide housing at affordable rents for the homeless and people on low income or with special needs. Set up as not-for-profit organisations, there are now some 2,100 RSLs. Between them they own or manage some 1.45 million homes, a third of the social housing stock in England, housing some 3.2 million people. Some £24 billion of public money has been invested in RSLs' housing assets and annual grants to RSLs are planned to rise from £811 million in 1999-00 to £1.2 billion in 2003-04. Since 1992-93, the sector has also raised some £20 billion in private finance and continues to borrow between £1.5 billion and £2 billion a year from private lenders such as banks and building societies.

3 In managing these resources, RSLs face a variety of financial risks and are responsible for the day-to-day management of them, while the Corporation is responsible for regulating how well they do this. The Corporation has the complex task of seeking to ensure that tenants' homes and taxpayers' investments are protected while also avoiding restriction on RSLs' scope to engage in well-managed risk taking. Our main findings are:

The Corporation and the sector have a good record in avoiding RSL financial failure. The Corporation has helped to engineer rescues of the few RSLs that have got into serious financial difficulty. As a result, no RSL has become bankrupt and no tenants have lost their homes in the last 10 years.

1 *Most registered social landlords (RSLs) are housing associations, but RSLs also include trusts, co-operatives and companies. Some housing associations choose not to register with the Housing Corporation and do not receive public funds.*

However, the sector is growing and becoming more complex and the risks are changing. RSLs are having to work their finances harder and increase their use of private finance, and many are diversifying into new business activities and partnerships with other organisations.

In response, the Corporation has embarked on a "regulation revolution" to make regulation less prescriptive and more targeted on areas of greatest risk. As this initiative moves forward, we recommend that the Corporation:

- strengthen its financial ratio analysis and ensure that, in replacing its performance standards with a new regulatory code, it identifies and focuses on good management of the key risks in the sector;
- collect and use more relevant and reliable information for its regulatory assessments, without increasing the regulatory burden on RSLs;
- improve the training and qualifications of regulatory staff, so that they may better regulate the sector as it grows and becomes more complex; and
- remedy problems more quickly, and make its regulatory assessments more transparent to the various stakeholders in the sector.

These main findings are elaborated on in the rest of this Summary.

Detailed findings and recommendations

4 The Housing Corporation has recently embarked on a "regulation revolution" to change the way in which it regulates the RSL sector:

- **Regulation will focus on financial management and governance**, to help prevent RSLs from getting into financial difficulty. The Corporation intends to target its efforts on those RSLs presenting the greatest risk. It also plans to allow RSLs more freedom to manage, with regulation focusing on outcomes rather than compliance with detailed procedural requirements. Greater emphasis will be placed on RSLs' own risk appraisals and the way in which RSLs propose to manage the risks identified.
- A newly introduced system of **Best Value and inspection will focus on the service delivered to tenants**, and will aim to encourage continuous improvement in these services. This will be similar to the Best Value regime which applies in local government and in relation to local authority housing.

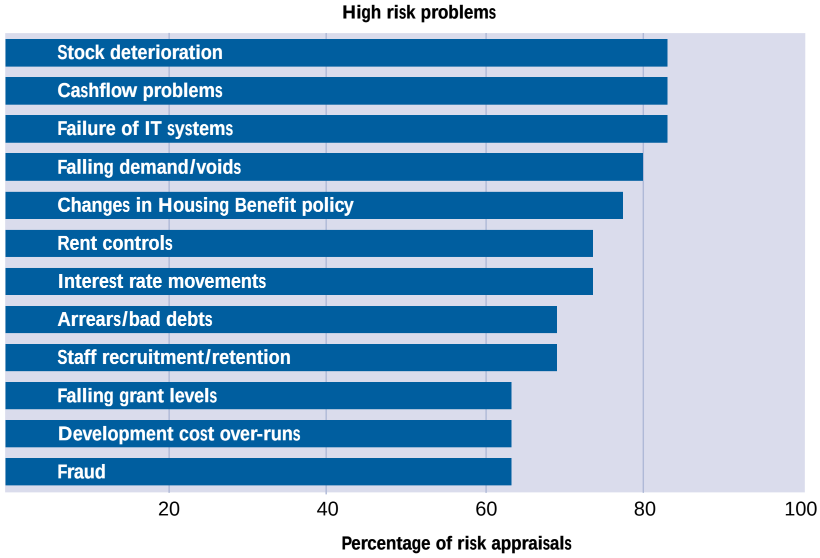
Our main findings and recommendations below are relevant to the regulation of financial management, and take into account this shift in regulatory approach.

On focusing on the key financial risks in the sector

5 Guidance issued by the Housing Corporation in May 1998 identified 20 potential risks facing RSLs but did not quantify the extent of those risks or how likely they were to materialise. The guidance accompanied the Corporation's introduction of a mandatory requirement that all RSLs with 250 or more homes carry out their own annual risk appraisals and report the results to their Boards and the Corporation. The risk appraisals of 42 RSLs we examined identified 12 common threats (see **Figure 1**). RSLs have direct control over some of these risks, such as stock deterioration, cash flow problems and failure of IT systems, and other risks are determined externally such as changes in Housing Benefit policy, rent controls and interest rate movements. If any of these risks mature, they have the potential to impact on an RSL's cash flow, causing loss or financial failure. Ultimately, severe financial losses could result in higher rents or poorer living conditions for tenants. A financial failure might also jeopardise grant monies or an RSL's ownership of publicly funded assets.

1 **The 12 most common high-risk problems identified in RSL risk appraisals**

The most common and highest risks identified in RSL risk appraisals were associated with RSL's traditional business activities.



Source: National Audit Office review of a selection of 42 RSL risk appraisals

6 To date, the Corporation and the sector have been successful in preventing the key risks of RSL insolvency and loss of tenants' homes. There have been no RSL insolvencies over the past 10 years resulting in losses of tenants' homes, despite an increase in the size and complexity of the sector. In the handful of cases each year where RSLs have encountered severe financial difficulties, the Corporation has helped engineer the transfer of their properties and tenancies to other financially stronger RSLs.

7 The Corporation issued performance standards setting out detailed requirements on how RSLs should be governed and how their finances should be managed. The Corporation is replacing these prescriptive, detailed standards with a new regulatory code setting out the key attributes of an RSL that is performing well. This code will be mandatory and will focus on the outcomes RSLs are expected to achieve rather than the former approach of specifying the processes needed to achieve them. RSLs are expected to identify their own key risks and to make their own arrangements for managing them. At the same time regulatory attention is shifting towards those RSLs that present the greatest risk, by placing greater emphasis on the lead regulation of the largest RSLs and profiling and scoring RSLs according to the risks that they pose. The

Corporation will need to pay more attention to the quality of RSLs' risk appraisals and monitor the effectiveness of its new regime to ensure that there is no dilution of the high standards of performance, probity and accountability expected from the sector. The Corporation should also be alert for signs of financial difficulties arising in those RSLs which it has assessed as less risky.

8 The Corporation applies financial ratio analysis to RSLs' financial statements in order to identify actual or potential financial risks and to indicate where further regulatory scrutiny and action might be required. Although the sector remains financially healthy, surpluses have been falling as RSLs face increasing financial pressure and some RSLs may be moving into tighter financial positions. For example, in 1998-99 around 10 per cent of RSLs reported deficits before transfers to reserves, and just over a half of these had also reported a deficit in the preceding year. The number of RSLs passing the Corporation's key financial ratios has steadily declined and in 1999-00 the Corporation's target of 85 per cent compliance was not met for six out of the eight key financial ratios, although the Corporation and lenders consider that these trends are not yet a cause for concern.

9 Our review of the financial ratios, commissioned from Standard & Poor's, concluded that the ratios provided a coherent and relatively robust way of identifying those RSLs that were most at risk financially. However, some of the ratios needed to be revised or replaced, in particular, to improve the Corporation's ability to identify the key operational risks of stock deterioration, cash flow problems and interest rate movements. We also found that the ratios are not appropriate for large-scale voluntary transfer RSLs, where the structure of the RSLs' finances mean that they automatically fail most of the Corporation's ratios. The Corporation has appointed consultants to review changes to the ratios and to help devise new ratios for large-scale voluntary transfer RSLs.

10 In order that it may better focus its regulatory attention on the key risks in the sector, the Corporation should:

- ensure that the consultants reviewing the financial ratios consider all of the financial ratio changes recommended in this report, and also increase the use of financial trend analysis, benchmarking and inter-regional comparisons.

On getting the right information to make regulatory assessments

11 The Corporation has examined some sector-wide risks, including risks associated with the use of private finance and changing patterns of housing demand. However, it has not assembled a comprehensive picture of financial risk in the sector, although it is now working towards developing one based on the risk profiling work of its new Financial Appraisal Teams. It could also make better use of sector accounts, performance returns, the collective experience of its lead regulators[2] and RSL risk appraisals to compile such an assessment.

12 RSLs' risk appraisals have an important part to play in the Corporation's new regulatory approach. We examined the risk appraisals of 42 RSLs and found that they varied widely in their content. Some adopted a strategic approach, highlighting around a dozen key business risks, while others set out hundreds of risks in detail. Many did not allocate responsibility for managing them or identify the likelihood of each risk materialising or its potential impact on the RSL. The Corporation's guidance, *A Strategy for Success: Effective Risk and Business Management*, published in December 2000 pointed out that some RSLs had used the risk appraisal process effectively to identify risks but, in some cases, had lacked a strategic focus. Moreover, risk appraisal had often been a one-off project, rather than a tool to manage risk actively. The guidance identified the elements of a risk management framework for identifying and managing risk and encouraged RSLs to adopt that framework.

13 Although the Corporation obtains regular and extensive information about the governance, finances and financial management of individual RSLs, we noted that the information was not always complete. For example, we noted that financial data, including audited accounts, had been received late, hindering the Corporation's assessment of RSLs' financial positions. The Corporation currently makes little use of work planned or undertaken by RSLs' internal auditors, although it is working with the RSL Internal Audit Forum to develop a protocol on what regulators should look at in respect of internal audit work.

2 Each large RSL with over 250 housing units is assigned an experienced regulator, known as a lead regulator, by the Corporation. The lead regulator gains a strategic overview of the RSL and its business through discussions with its senior management team and Board and high level documentary review.

14 Each year, RSL governing bodies have been required to self-certify the extent to which they comply with the standards. The Corporation used this information to help it determine whether an RSL's governance and systems of financial control were satisfactory or whether there were any problems that warranted closer scrutiny as an observation or a supervision case. However, RSLs' self-certification has not always been reliable. At the 20 RSLs that we visited, RSLs had not sought to validate the information that they provided in their performance returns. In 1999-00, some 45 per cent of the Corporation's visits to RSLs to validate their self-certified returns resulted in RSLs being reclassified, mostly from satisfactory status (no problems identified) to observation status (cause for concern), although some where re-classified to supervision status (cause for serious concern). Around a quarter of reclassifications related to financial concerns. Not all of these reclassifications resulted from mis-certification. Some might have been due to deterioration in RSL performance since the time they submitted their returns. However, the Corporation does not collate information on the grounds for reclassification, so it is not possible to draw firm conclusions on the reliability of RSLs' performance returns. The Corporation is considering the extent to which its new regulatory code will necessitate a programme of follow-up visits to assess RSLs' compliance with the code.

15 In order to have better information for its regulatory assessments, the Corporation should:

- monitor the quality of RSLs' risk appraisals to ensure that they have identified key financial risks and have adopted appropriate strategies for managing them;
- undertake a regular and systematic appraisal of the nature and extent of financial risks in the sector to help it better focus its regulatory efforts where there is the greatest financial risk. This appraisal could draw on the analyses recently developed for the Corporation to rank all large RSLs by risk, together with RSLs' annual risk appraisals, financial returns and performance returns, as well as specially commissioned research projects and periodic surveys. To enhance public accountability and provide feedback to the sector, the results should be used to produce an annual report on the financial health of the sector;
- ensure that regulatory staff assemble complete and timely information about RSLs' financial management and performance, including improved risk appraisals and the results of internal auditors' work; and
- continue with a programme of visits to follow up cases where problems are identified or suspected, to assess RSLs' compliance with the new regulatory code.

On reaching the right regulatory judgements

16 The number of staff employed on financial regulation has not kept pace with the increase in regulatory workload, and regulatory staff need more qualifications, training and business experience to match the increasing financial complexity and sophistication in the sector. Both these factors may jeopardise the Corporation's ability to regulate RSLs' management of financial risk. The Corporation has begun to address these issues, particularly through the establishment of a Lead Regulation Unit in December 1999 and the recent appointment of 15 new financial appraisal officers. It has recently reorganised its regional structure and is shortly to undertake a review of its Headquarters functions, as part of its modernisation programme. And, more generally, the Department has allocated additional resources to strengthen regulation over the next few years.

17 We noted that, where RSLs failed the Corporation's financial ratios, regulatory staff looked for compensating factors to offset the failures rather than fully investigate the causes and consider remedial action that could be taken. The Corporation does not have the resources to follow up all financial issues in every RSL and it is sensible for it to target its limited resources towards the most serious cases. However, its regulatory staff routinely accepted that RSLs had problems with rent arrears and Housing Benefit receipts without considering whether the RSLs were taking action to address them, at least to reduce the financial impact on their businesses. The Corporation has not issued guidance to its staff on how financial problems such as these should be viewed by regulatory staff and the extent to which the Corporation's concerns should be brought to an RSL's attention.

18 In order to ensure that it reaches the right regulatory judgements, the Corporation should:

- ensure that it commits sufficient resources to deliver its financial regulatory activities, and strengthen the skills and experience of its regulatory staff so that they may better regulate a growing and increasingly complex sector; and
- bring to RSLs' attention the underlying financial problems that it has identified so that RSLs are fully aware of them and may consider whether any action is required to prevent them from becoming more serious.

On acting on the results of its regulatory assessments

19 Where problems are identified lenders and most RSLs considered that, in general, the Corporation had handled observation and supervision cases well. However, some supervision cases run on for a long time, with 55 per cent of cases taking more than two years to resolve and 28 per cent more than four years. The Corporation has not set targets for resolution of problem cases or maintained and analysed data on how long it had taken to clear observation cases or on the extent of recidivism. Nor does its supervision database allow such analysis. Recently, however, the Corporation has increased the attention given to supervision cases to bring about earlier and more effective remedy.

20 There is scope for the Corporation to communicate more formally to RSLs the issues identified in its financial ratio analysis and its review of RSLs' compliance with performance standards. The Corporation has not explained its financial ratios and benchmarks to RSLs, how they are used or how RSLs have performed against them. It intends to issue guidance to RSLs once it has finalised its new ratios. Nor does the Corporation routinely or systematically seek feedback from RSLs on its overall performance as a regulator. The Corporation is putting in place protocols for sharing information with lenders and local authorities. It has also launched a pilot exercise to make its regulatory assessments of RSLs and its investment decisions publicly available on its Internet website. It is also considering proposals to institute a new system whereby RSLs may appeal against regulatory judgements.

21 In order to ensure that its regulatory assessments are acted upon in a timely fashion, the Corporation should:

- monitor, record and report on progress on the resolution of supervision and observation cases, to ensure that problem cases are resolved promptly; and
- ensure that all RSLs are provided with timely and appropriate feedback on the results of regulatory visits and reviews, and push on with its pilot exercise on publishing its regulatory assessments of RSLs so that this information is put into the public domain as soon as possible for the benefit of all stakeholders in the sector.

Part 1

Introduction

1.1 The Housing Corporation (the Corporation) is a non-departmental public body sponsored by the Department of the Environment, Transport and the Regions (the Department). The Corporation has two main functions - paying grants to housing associations and other registered social landlords[1] (RSLs) to provide social housing; and regulating RSLs' governance, financial performance and their development and provision of social housing, in order to protect the interests of tenants and taxpayers. This report focuses on the Corporation's regulation of RSLs' financial performance, and particularly their management of financial risk.

What are registered social landlords?

1.2 Registered Social Landlords are either registered charities, industrial and provident societies or companies registered with the Corporation. They provide housing at affordable rents for the homeless and people on low income or with special needs. Set up as not-for-profit organisations, there are now some 2,100 landlords registered with the Corporation. Between them they own or manage over 1.45 million homes, a third of the social housing stock in England, housing some 3.2 million people. In 1999-00, RSLs had a combined turnover of £4.6 billion and employed some 89,000 staff, while some 21,000 volunteers served on RSLs' governing boards and committees.

1.3 RSLs range in size and complexity from small almshouses with less than 20 homes to major housing associations with over 40,000 homes. The Corporation categorises them according to their size: small (less than 250 housing units); medium (250 to 1,000 units); and large (over 1,000 units). Many large and medium sized RSLs are dynamic organisations, keen to expand through new development, diversification into new business activities and partnerships with other organisations. Some landlords are now partners in regeneration initiatives that seek to address the related issues of employment, education, transport and housing.

1.4 The RSL sector expanded rapidly during the 1990s, as properties were transferred from local authority ownership to existing or newly constituted Registered Social Landlords through the Government's Estates Renewal Challenge Fund and Large Scale Voluntary Transfer programmes. Both of these programmes involve RSLs using private sector loans to buy properties from councils and improve their condition. The sector is likely to expand still further, when the initiatives set out in the Government's recent housing policy statement (*Quality and Choice: The Way Forward*, December 2000) to transfer more properties from local authority ownership and control are enacted.

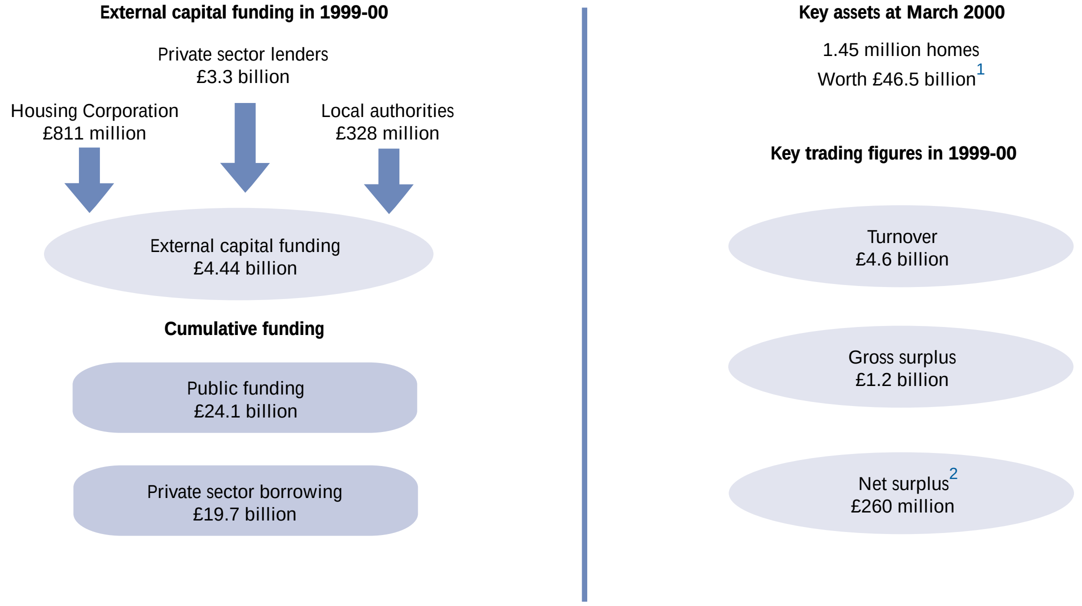
How much public money has been invested in RSLs?

1.5 By registering with the Corporation, a landlord becomes eligible to apply for housing grant from the Corporation to build new homes or to acquire, refurbish and renovate existing ones. The Corporation's annual capital grants to RSLs declined from some £2.4 billion in 1992-93 to £811 million in 1999-00, although the decline has now been reversed with annual grants planned to rise to £1.2 billion in 2003-04. RSLs have looked increasingly to the private sector and local authorities for development funding. **Figure 2** shows that, despite the reduction in Corporation grant funding and an increasing reliance on private finance, large sums of public money still flow into RSLs each year and that there is an accumulated investment of over £24 billion of public money in the assets of RSLs.

1 Most registered social landlords (RSLs) are housing associations but RSLs also include trusts, co-operatives and companies. Some housing associations choose not to register with the Housing Corporation and do not receive public funds.

2 Registered Social Landlords manage substantial public and private resources

Registered Social Landlords continue to receive large sums of public money and are responsible for managing around £46.5 billion worth of housing assets, half of which was funded from public monies.



Notes: 1. Most RSLs value their fixed assets at historic cost in their balance sheets, although some might use current market valuations.
2. Net surplus is shown after deductions for tax, interest payable and other items.

Source: National Audit Office

What are the aims of financial regulation?

1.6 The Corporation's overall regulatory objective is to ensure that RSLs are effective in providing social housing and that the interests of tenants and taxpayers are properly safeguarded. As part of this task, the Corporation regulates the financial affairs of RSLs to ensure that they:

- manage their affairs effectively;
- operate to high standards of probity and make responsible use of public resources; and
- sustain a reputation for sound management and financial strength, to ensure that they continue to attract private funding for investment in social housing.

1.7 Individual RSLs, as independent organisations with their own governing boards, are responsible for the day-to-day management of the risks faced by their businesses. They are legally required to have their annual financial statements externally audited and the Corporation requires all RSLs that own or manage more than 2,000 homes to be subject to internal audit. Most RSLs have to meet the disclosure requirements of the Combined Code on corporate governance. They must disclose, in their annual financial reports, that an on-going process for identifying, evaluating and managing the significant risks faced by the organisation has been in place during the year and has been regularly reviewed by their Board.

Why is financial regulation important?

1.8 RSLs face a variety of risks that could have a bearing on their financial position **(Figure 3)**. Risks might arise from an RSL's ongoing operations through, for example, a delay in the receipt of rent payments or a failure to maintain properties, or RSLs might incur risks through borrowing on the wrong terms or when they cannot afford to meet loan repayments. Investment and innovation, such as diversification into new business activities, could bring new risks to an RSL's business. Risks might also come about as a consequence of RSL re-organisation where, for example, an RSL sets up subsidiaries that might prove to be loss-making or complicate governance and managerial oversight.

1.9 If any of these risks matured, they might lead to loss or financial failure. Any such loss or failure might harm the interests of tenants, who might be required to pay higher rents or live in poorer housing; ultimately, severe financial losses could lead to houses being lost from the sector although, with security of tenure, tenants would not lose their homes. A financial failure could also jeopardise grant monies or an RSL's ownership of housing assets which the taxpayer has helped fund. It is therefore important, and central to its role of protecting tenants and taxpayers, that the Corporation ensures that RSLs manage financial risks properly and prevent significant loss or financial failure.

3 **Examples of financial risks that RSLs might face**

RSLs face risks from a variety of sources.

Risks from social housing include:

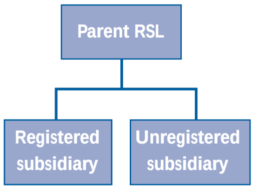
- Delay in the receipt of rentpayments
- Inadequate provision for stock repairs
- Loss of demand for housing
- Reduction in Housing Benefit receipts

Risks from borrowings include:

- Interest rates on variable rate borrowings rise more rapidly than predicted
- Over-optimistic business assumptions not realised
- Inability to re-pay loans as they fall due

Risks from new business activities include:

- Lack of expertise in new activities
- Diversion of managerial attention from traditional social housing activities
- Reliance on third parties that are new to RSLs
- Poor project management resulting in losses



Risks from re-organisation include:

- Financial impact on parent RSL of failure of subsidiaries
- Added managerial complexity
- Subsidiaries with financial problems might drain finances from other parts of group, unseen by RSL Board

Source: National Audit Office

How does the Corporation regulate financial risk in RSLs?

1.10 The Corporation's task in regulating the sector is not to eliminate risk altogether but to ensure that risk is properly managed. This involves appraising the risks faced by individual RSLs and the sector as a whole and putting measures in place to help RSLs manage risks, detect significant problems when they occur and facilitate timely and lasting remedy. To do this, the Corporation:

- obtains regular information on the finances, governance and financial management of RSLs;
- assesses this information to identify the extent to which RSLs are financially solvent and viable and meet performance standards set by the Corporation for their governance and financial management; and
- acts on the results, using its powers and resources to remedy weaknesses, where necessary, and providing feedback and identifying lessons to be learned.

1.11 The Corporation is making major changes to the way it regulates RSLs. Appendix 1 describes the key stages that made up the Corporation's regulatory process at the time of our examination over the period April to August 1999. The Corporation's regulatory assessments resulted in an RSL being categorised as a satisfactory case where there were no identified problems, an observation case presenting cause for concern, or a supervision case where there was serious cause for concern. On observation and supervision cases, the Corporation took action, depending on the nature and the seriousness of the problem identified.

1.12 In December 1999, the Corporation set up a Lead Regulation Unit at its headquarters to strengthen its regulation of the largest and most complex RSLs and in May 2000 published its policy on regulating RSL diversification into new business activities. More recently, the Corporation has embarked on a "regulation revolution" involving changes in its approach to regulation, including:

- the development of a risk-based approach to regulation, focusing on those RSLs that have the greatest exposure to risk and reducing the regulatory burden for smaller RSLs;
- consultation with the sector on a new regulatory code which will replace the Corporation's performance standards concerned with RSL governance and financial management and the provision of social housing, focusing instead on the key outcomes to be achieved and the way RSLs manage their overall resources and risks;
- the establishment of Financial Appraisal Teams in regional offices to carry out reviews of RSL diversification, rent investigations, risk management reviews and reviews of RSLs' financial sustainability over the longer-term;
- the creation of a Stock Transfer Registration Unit at headquarters to improve the Corporation's ability to handle the increasing number of Large Scale Voluntary Transfers of stock from local authorities to RSLs that are expected over the next few years; and

- implementation of its new Best Value and housing inspection regime, similar to that used in local authorities, to bring about continuous improvement in the quality of housing services provided by RSLs.

The Corporation introduced most of these changes in 2000 and will put others in place in 2001.

How has the Corporation organised its regulatory function?

1.13 The Corporation is managed by a Board, consisting of the Chief Executive, who is the Accounting Officer, and non-executive members who are appointed by Ministers. The Board has established a Registration and Supervision Committee which is advised by senior Corporation staff. The Board has overall responsibility for policy on registration and regulation of RSLs, while the Committee determines the outcome of registration applications and oversees the handling of the more serious problem cases. Regulation Division at headquarters is responsible for promulgating regulatory policies, establishing regulatory practices, providing guidance and monitoring the use of resources and the implementation of the regulatory regime, including handling serious problem cases and overseeing the progress of those less serious problem cases that are currently handled at regional level.

1.14 During the period of our examination, the Corporation had devolved day-to-day responsibility for financial regulation to its regional offices. There were 47 staff involved in financial regulation; 40 staff in seven regional offices, supported in financial regulation matters by seven staff at the Corporation's London headquarters. The Corporation is re-organising and strengthening its regulatory function from April 2001. It has appointed a new Assistant Chief Executive and four new Directors of Regulation. Each Director will have teams responsible for financial appraisal, lead regulation and the new function of inspection. The new structure is shown at **Figure 4**.

1.15 The Corporation's total running costs were some £32 million in 2000-01. Around £5 million of this was spent on financial regulation of RSLs. Although expenditure on financial regulation is small, this work has a major impact on the way in which RSLs manage billions of pounds' worth of assets and spend substantial sums of public money.

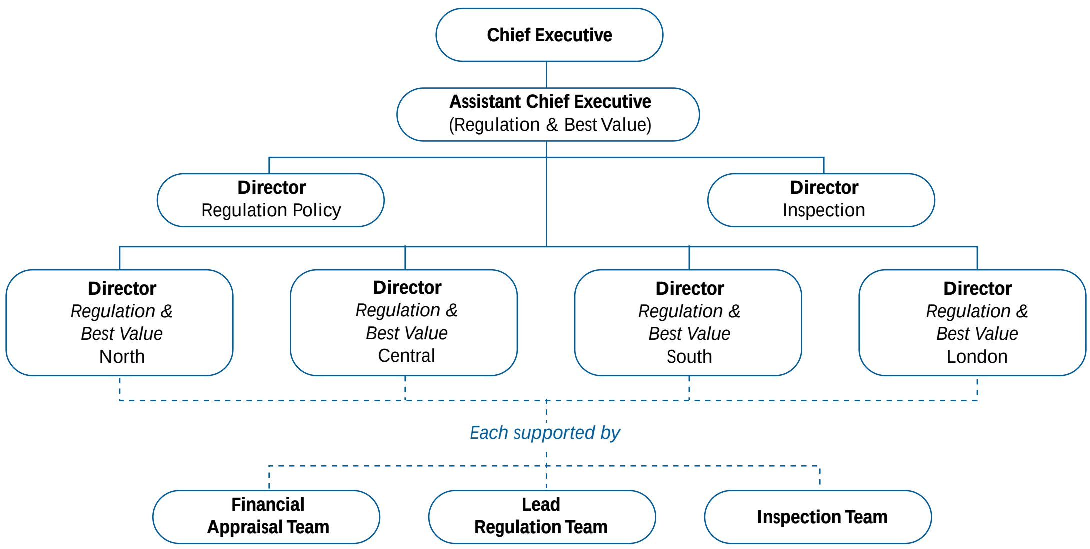
What did we examine?

1.16 The Comptroller and Auditor General and the Committee of Public Accounts last reported on the financial management of RSLs in 1993 and 1994 respectively. The Committee highlighted several areas for improvement. The Corporation and, where necessary, the Department have taken action to address these areas. Appendix 2 sets out the Committee's recommendations, the Government's response and action taken subsequently by the Corporation.

1.17 However, as we discuss above, the RSL sector has changed over recent years and is continuing to develop in new directions. The large influx of private sector money, the growth in the number of homes managed and diversification into new areas of business all bring potentially new or increased financial risks to the sector. This report takes account of these changes, as well as

4 How the Housing Corporation's regulation is organised

From April 2001, the Housing Corporation will carry out most of its regulatory work through four Directors of Regulation and Best Value, each supported by separate financial appraisal, lead regulation and inspection teams.



Source: *Housing Corporation*

developments in the regulatory regime, particularly those being introduced as part of the Corporation's "regulation revolution". This report also recognises the complexity of the Corporation's regulatory task as it seeks to ensure that tenants' homes and taxpayers' investments are protected, while also avoiding restrictions on RSLs' scope to engage in well-managed risk taking.

1.18 This report examines whether, in carrying out its regulatory role, the Corporation has been effective in:

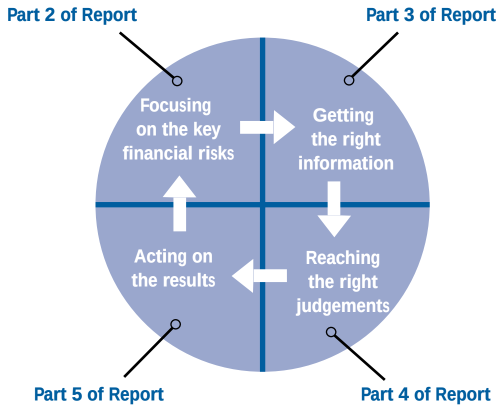
- focusing its efforts on key financial risks in the sector (Part 2 of our report);
- getting the right information to identify the financial risks faced by RSLs and the sector as a whole (Part 3);
- reaching the right regulatory judgements (Part 4); and
- acting on the results (Part 5).

What did we do?

1.19 Appendix 3 describes our study methodology in detail. Our study involved work at the Corporation's headquarters and at five regional offices, visits to 20 large RSLs and a survey of 210 RSLs of varying sizes over the period April to August 1999, analysis of information on the Corporation's regulatory databases, a review of the risk appraisals of 50 RSLs, interviews with eight leading financial institutions and consultation with other key stakeholders. We were assisted on our visits to RSLs by a senior consultant from HACAS Ltd, specialists in housing finance and management. We commissioned Standard & Poor's, a major credit rating agency with experience of the RSL sector, to review the appropriateness of the financial ratios and benchmarks used by the Corporation to assess RSLs' solvency and financial viability. We also received advice and assistance from an advisory panel which included representatives from the Corporation, RSLs, the Department, and the National Housing Federation, and also an academic and a risk analyst.

5 The risk management framework used in this report

The risk management framework we used for reviewing the Corporation's regulation of financial risk had four key elements: focusing on key financial risks in the sector; getting the right information; reaching the right judgements; and acting on the results.



Source: National Audit Office

1.20 We assessed the Corporation's regulatory activities and performance against a broad risk management framework, which reflected best professional practice and the academic literature on risk management, modified to take account of the Corporation's regulatory role **(Figure 5)**. We also compared the Corporation's regulatory approach with the principles set out in the Government's Better Regulation framework.

1.21 During 2000, the Department carried out a quinquennial review of the Housing Corporation, examining whether the Corporation's functions were still needed and, if so, whether the Corporation was the right body to carry out these functions and whether the Corporation had appropriate managerial and organisational structures. Early findings from our examination were available to the Department and helped inform its findings.

Part 2

Focusing on the key risks in the sector

2.1 This Part of the report examines whether the Corporation's regulatory regime addresses the key financial risks faced by RSLs. In particular, it examines:

- whether the Corporation has helped prevent the risk of serious financial failure in the sector (paragraphs 2.2 to 2.10); and
- whether the regulatory regime addresses the key operational risks identified by RSLs (paragraphs 2.11 to 2.21).

Has the Corporation helped prevent the risk of serious financial failure in the sector?

2.2 In regulating RSLs' management of financial risk, the Corporation aims to ensure that the interests of tenants and taxpayers are properly safeguarded. It also seeks to ensure that RSLs sustain a reputation for sound management and financial strength so that they may continue to attract private funding for investment in social housing, and that they manage their affairs effectively.

2.3 Overall, the Corporation has a good record in preventing serious failures. Over the past 10 years, there have been no insolvencies of any RSL resulting in losses of tenants' homes despite an increase in the size and complexity of the sector. To date, when RSLs have encountered severe financial difficulties it has been possible to transfer properties and tenancies to another social landlord. For example, in the four years to March 2001, 13 RSLs faced severe financial difficulties and were rescued by being merged with financially stronger RSLs through the joint action of the Corporation and lenders.

2.4 Our analysis confirms that the sector as a whole remains financially healthy. We compared balance sheet and income and expenditure items for all RSLs as at March 1996 with those at March 2000. As a group, RSLs were solvent at March 2000, with current assets in excess of current liabilities. Total net fixed assets exceeded borrowings, suggesting that there were uncommitted assets that might be available for use as security for future loans (see accounts in Appendix 4). Between 1996 and 2000, the sector's balance sheet strengthened, with total assets less long-term loans increasing by more than £3 billion. The sector's financial strength, aided by the Corporation's regulation, has helped the sector attract large sums of private finance. Since 1992-93, the sector has raised some £20 billion in private finance and continues to borrow between £1.5 billion and £2 billion a year from private lenders such as banks and building societies at competitive rates.

Is the sector becoming riskier?

2.5 The sector has come under increased financial pressure in recent years and this trend can be expected to continue, bringing with it increasing risk. Government policy has been to encourage RSLs to make better use of their financial resources, particularly in taking on and managing more risk. The Corporation funds a smaller proportion of the capital costs of new developments than in the past, requiring RSLs to borrow more and to adopt more sophisticated approaches to business planning. The Corporation bears down on rent levels and has also acted against high rent increases. Where once RSLs could raise rents to fund future developments or recoup losses, their scope to do so is now curtailed. Since April 1998, the Government has required RSLs to keep their annual rent increases to no more than the level of the Retail Price Index plus one per cent (known as RPI +1). The Government's recent housing policy statement (*Quality and Choice: The Way Forward,* December 2000) plans that, from 2002-03, rent increases should be limited to RPI+0.5 and rents would be re-structured based on relative property values and local earnings. Some RSLs would see rental income decrease, while others would see it rise.

2.6 The sector makes a surplus each year, making funds available for investment, although these surpluses have been falling. The sector's net surplus, after tax and interest and before transfers to reserves, fell from 13 per cent of income from lettings in 1995-96 to 6 per cent in 1999-00. Within these aggregate figures, some RSLs may be moving into tighter financial positions. For example, in 1998-99 around 10 per cent of RSLs reported deficits before transfers to reserves, and just over a half (57 per cent) of these had also reported a deficit in the preceding year. Lenders we consulted were unanimous that, although the sector was getting riskier, it was still very attractive for investors. Whilst some lenders considered that they were approaching the limit of their exposure to the sector, there was general acknowledgement that funds were still available for RSLs that wanted to borrow.

2.7 The effect of increasing financial pressures can also be seen in the decline in the percentage of large RSLs passing the financial ratios that the Corporation uses to assess landlords' solvency and financial viability and signal any actual or potential financial problems. An explanation of each financial ratio is at Appendix 5. The Corporation set a target that each ratio should be passed annually by 85 per cent of RSLs. Over the seven years 1993-94 to 1999-00 there has been a decline in the percentage of large RSLs passing seven of the Corporation's key ratios **(Figure 6)**. In 1999-00, the Corporation's target was not met for six out of the eight ratios.

2.8 Figure 6 shows a deteriorating trend in four key areas:

- **rent arrears**, which measures whether an RSL has problems in getting rents paid. Here, the Corporation's target of an 85 per cent pass rate has not been achieved in any of the last seven years and deterioration in RSL performance has been sharpest, resulting in 66 per cent of RSLs whose returns had been agreed failing the ratio in 1999-00. A review commissioned by the Corporation found that 31 per cent of rent arrears was due to payment of Housing Benefit four weeks in arrears and 25 per cent was attributable to difficulties in processing Housing Benefit payments;
- **rent gearing**, which measures whether an RSL's debt is sustainable. The Corporation's target of an 85 per cent pass rate has not been achieved in any of the last seven years. The pass rate against this ratio has fallen steadily over the period, leading to a 45 per cent failure rate in 1999-00. The Corporation attributed this to increased borrowing by RSLs and a rent influencing regime which constrained RSLs' rental income;

6 **The percentage of large RSLs[1] passing the Corporation's financial ratios, 1993-94 to 1999-00**

Over the seven years 1993-94 to 1999-00, there has been a steady decline in the percentage of large RSLs passing the Corporation's financial ratios.

Financial Ratio	Percentage of large RSLs that passed the ratio (shaded cells show targets not met)						
	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00[2]
Quick ratio	92	89	**83**	87	85	**82**	**68**
Cash flow ratio[3]	**84**	89	88	96	**79**	**79**	N/A
Unqualified accounts	100	100	100	100	100	100	100
Rent gearing	**75**	**75**	**74**	**71**	**65**	**60**	**55**
Gearing reserves	93	94	92	96	94	93	87
Interest cover	95	96	94	95	**82**	**79**	**72**
Increasing reserves	92	93	**84**	**83**	**83**	88	**82**
Rent losses	85	86	85	**75**	**72**	**75**	**59**
Rent arrears	**74**	**74**	**76**	**67**	**58**	**55**	**34**

Notes: 1. RSLs created under the Large Scale Voluntary Transfer programme have financial structures that are dominated by private sector loans. As a result, they fail most of the Corporation's financial ratios. We have therefore excluded these RSLs from the above analysis.
2. Data from around 20 large RSLs, representing around 10 per cent of the population, had not been finalised as at December 2000, and are omitted from one or more of these ratios.
3. The Corporation discontinued the use of the cash flow ratio in 1999-00, replacing it with the Funds Flow ratio, as recommended by Standard & Poor's. As at December 2000, around 75 per cent of large RSLs had passed the new Funds Flow ratio.

Source: Housing Corporation FISS database

- **rent losses**, which measures whether an RSL has problems with empty properties (voids) and bad debts. Here, the RSL pass rate has fallen sharply in the past four years, resulting in a failure rate of between 25 and 41 per cent. The Corporation attributed much of this to low and falling demand. The Corporation's new Financial Appraisal Teams are now using low demand as one of the factors in their risk profiling system; and
- **interest cover**, which measures how much of an RSL's income is required to pay interest charges on its outstanding loans. In 1999-00, 28 per cent of RSLs did not meet the minimum cover required by the Corporation. The Corporation pointed out that lending to the sector increased significantly over the period covered by our analysis. Inflation fell steadily, which meant that the real value of RSLs' debts had not been eroded as quickly as in earlier periods.

2.9 1999-00 also saw a decline in the percentage of RSLs passing the quick ratio and the increasing reserves ratio:

- The quick ratio measures an RSL's ability to meet its debts from its liquid assets, such as cash at bank. In 1999-00, 32 per cent of RSLs failed this ratio. The Corporation pointed out that many RSLs adopt a treasury management policy of not carrying large cash balances, drawing down cash facilities only when required and benefiting from lower borrowing costs. However, as a result, more RSLs are failing the quick ratio.
- The increasing reserves ratio assesses whether an RSL is adding to its accumulated surplus. In 1999-00, 18 per cent of RSLs failed this ratio. The Corporation pointed out that the ratio does not take account of any transfers from an RSL's accumulated surplus to its designated reserves. The Corporation told us that the fall in the number of RSLs passing this ratio was due to an increasing trend of RSLs transferring surpluses to designated reserves for future expenditure commitments.

2.10 The Corporation told us that lenders considered that the benchmarks used by the Corporation to assess RSLs' financial health should not be lowered as this could allow some RSLs that might be a cause for concern to slip through the financial ratio analysis without a detailed review. The Corporation has therefore decided not to reduce any of its benchmarks. However, it is now reviewing the appropriateness of the 85 per cent target for the percentage of RSLs that should pass its financial ratios.

Summary

The Corporation has a good record in preventing serious financial failure. There have been no RSL insolvencies over the past 10 years resulting in losses of tenants' homes. The sector as a whole remains healthy, although it has come under increased financial pressure in recent years and some RSLs may be moving into tighter financial positions. There has been a steady decline in the percentage of RSLs passing the Corporation's financial ratios, with particular deterioration in rent arrears and interest cover, although the Corporation and lenders consider these trends are not yet a cause for concern.

Does the regulatory regime address the key operational risks identified by RSLs?

2.11 In May 1997, the Corporation issued guidance to RSLs on risk management techniques, which listed some of the risks RSLs might face. The Corporation updated the guidance in May 1998, following the completion of pilot risk management strategies in 60 RSLs. The revised guidance provided examples to show what controls some RSLs had introduced and how they were monitoring risks. **Figure 7** summarises key risks set out in the guidance.

7 Risks facing RSLs

The Housing Corporation identified a wide range of risks facing RSLs.

- Substantial changes in government policies
- Economic changes affecting interest rates and inflation
- Significant changes in long-term tenant needs
- Skills of staff, Boards and consultants
- Incomplete information on housing needs
- Inappropriate rent levels and poor rent collection
- Onerous contract terms and conditions
- Inaccurate property valuations
- Changes to Corporation housing grants
- Incorrect project appraisal assumptions
- Increased competition
- Market forces affecting land values
- Failure of a new venture
- Information technology failures
- Funding major repairs
- Unaffordable rents
- Fraud
- Inappropriate treasury instruments
- Abuse of special care residents
- Local resident disturbances

Source: Housing Corporation

2.12 In May 1998, the Corporation introduced a mandatory requirement that all RSLs with 250 homes or more carry out their own annual risk appraisals and report the results to their Boards and to the Corporation by May 1999. Most recently, the Corporation published guidance, *A Strategy for Success: Effective Risk and Business Management*, which re-emphasised the importance of risk management and RSL Boards' responsibility for assessing risks and for ensuring that their organisations have adequate systems to manage them.

2.13 In July 1999, we selected 50 RSLs to examine their risk appraisals. Despite variation in the style and content of RSLs' risk appraisals, we were able to collate those risks that RSLs considered the most important **(Figure 8)**. Key risks identified by RSLs included those that they have direct control over - such as stock deterioration, cash flow problems and failure of IT systems - and others that are determined externally - such as changes in Housing Benefit policy, rent controls and interest rate movements. The risks associated with maintaining the condition of RSL stock, falling demand and changes in Housing Benefit policy featured prominently as major threats to RSLs' finances.

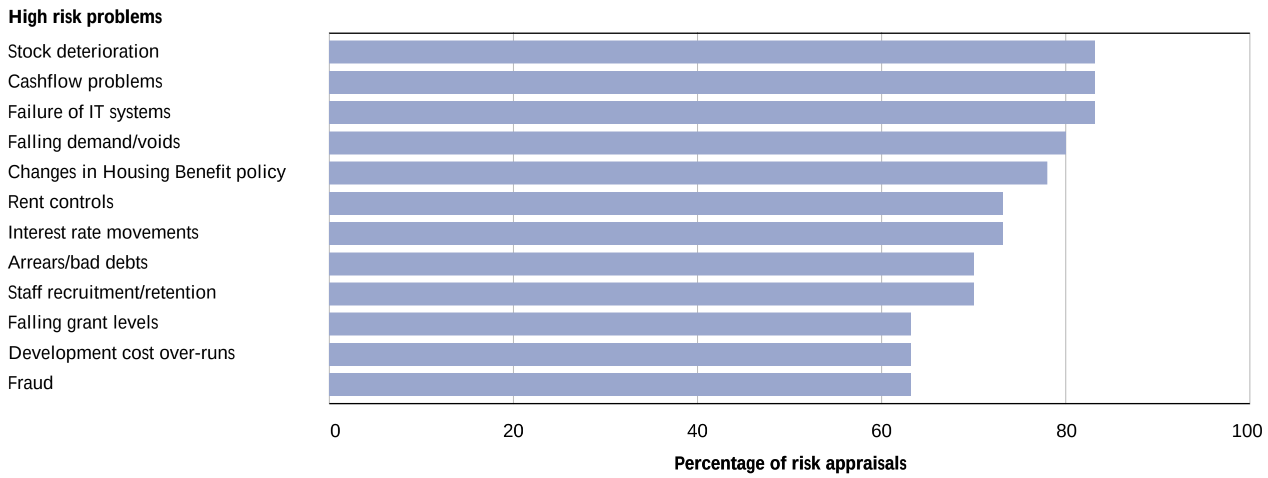
2.14 The Corporation provides RSLs with a range of guidance and information to help them manage the risks that they face and has various means of regulating the way in which they manage those risks. However, performance standards and financial ratios have been the cornerstones of the regulatory regime. Each year, RSLs have had to certify whether they comply with prescriptive and detailed performance standards, requiring them to exercise good governance and sound financial management over their business affairs and to provide a satisfactory level of service to their tenants. The Corporation has also applied financial ratios to RSLs' financial accounts to help spot existing or emerging financial problems.

2.15 Part 3 of this report will show that the majority of RSLs that responded to our survey commented favourably on the Corporation's performance standards. The Corporation is, however, replacing these standards with a new regulatory code, which will set out the key attributes of RSLs that are performing well. This code will be mandatory and will focus on the outcomes RSLs are expected to achieve, replacing the former approach which specified the processes needed to achieve them. The new code is less detailed, but more wide-ranging, than the performance standards. For example, the code contains a general requirement that RSLs operate a financially viable business. This encompasses the need to have adequate systems of internal control, arrangements to prevent and detect fraud, and an adequate risk management framework. The Corporation told us that it expects RSLs to identify their own key risks and to make their own arrangements to address them. At the same time, regulatory attention is shifting towards those RSLs that present the greatest risk, by placing greater emphasis on the lead regulation of the largest RSLs and profiling and scoring RSLs according to the risks they pose.

2.16 Under this new approach, the Corporation will need to pay more attention to the quality of RSLs' risk appraisals as the means by which RSLs identify risks and how they will manage them. In particular, there will be scope for the Corporation to help RSLs focus on key risks, such as those in Figure 8, which are likely to feature in many RSLs' risk appraisals. The Corporation will also need to monitor the effectiveness of its new regime to ensure that there is no dilution of the high standards of performance, probity and accountability expected from the sector. The Corporation should also be alert for signs of financial difficulties arising in those RSLs which it has assessed as less risky.

8 The 12 most common high-risk problems identified in the RSL risk appraisals that we examined

The most common and highest risks identified in the risk appraisals that we examined were associated with RSLs' traditional business activities.



Source: National Audit Office review of RSL risk appraisals

2.17 Our review of the financial ratios concluded that they provided a coherent and relatively robust way of identifying those RSLs that were most at risk financially. However, the ratios needed to be revised to improve the Corporation's ability to identify poor management of risks by RSLs in relation to stock deterioration, cash flow problems and interest rate movements. The scope to improve the Corporation's financial ratios, and the action taken by the Corporation to do so, are discussed in greater detail in Part 4.

2.18 In recent years, the Corporation has become concerned that RSLs are looking to diversify into new business activities, such as renting at market rates, and that this trend might lead to increased financial risks. Our survey of 210 RSLs showed that almost half of respondents had diversified in the previous three years and almost one-third planned to do so over the next three years. On average, new business activities represented some six per cent of the RSLs' turnover in the previous financial year and were likely to represent around seven per cent in the next financial year. Extrapolating across the sector as a whole, these figures suggest that over the next three years diversifying RSLs might invest some £1 billion in physical assets and take on financial liabilities of some £660 million. These figures represent, respectively, 4.6 per cent of the £21.7 billion in fixed assets and 4.6 per cent of the £14.2 billion in long-term and short-term loans disclosed in the sector's global balance sheet as at 31 March 1999.

2.19 However, risks arising from diversification did not feature prominently in RSLs' risk appraisals. Diversification was either not mentioned or classified as low risk in more than two-thirds of the appraisals reviewed. Half of the diversifying RSLs we surveyed considered that diversification had no impact on the financial risks faced by their organisations and a further 12 per cent considered that it actually reduced financial risk. Of the RSLs that had diversified, many stated that they had done so in order to offset the risks arising from stagnation or contraction of their social housing business. Diversification was seen as a way of spreading risk across RSLs' business portfolios.

2.20 Some 90 per cent of respondents specified various steps that they had taken to manage the new activities properly. The most common action included improved financial modelling, the development of formal risk appraisals and enhanced reporting to RSL Boards. However, many of the major lending institutions expressed concern that RSLs were diversifying without adequate preparation. They believed that many RSLs had not assessed the additional burdens that new activities would place on staff and that they had developed business plans that were sales documents rather than rigorous assessments of business viability. Although diversification might not yet be significant in financial terms compared with RSLs' traditional activities, its newness and the possibility of RSLs being less than fully prepared lend support to the Corporation's concern over the risks posed by diversification.

2.21 The Corporation can regulate diversification through, for example, RSLs' risk appraisals. It has also established a mechanism by which any RSL that diversifies by more than 5 per cent of its turnover or capital employed is required to provide information to the Corporation. The Corporation has also introduced control review visits to RSLs, to assess the risks arising from new business activities. The Corporation has also appointed consultants to review its policy, *Regulating a Diverse Sector*, in light of the data that it has collected since the policy was introduced in May 1999.

Summary and recommendation

Key risks identified by RSLs included maintaining the condition of their stock, falling demand and changes in Housing Benefit policy. Most RSLs commented favourably on the Corporation's performance standards. The Corporation is, however, replacing these prescriptive and detailed standards with a new regulatory code of good practice that RSLs should aim to follow. The Corporation expects RSLs to identify their own key risks and to make their own arrangements to address them. The Corporation will therefore need to pay more attention to the quality of RSLs' risk appraisals and help RSLs focus on the key risks. The Corporation will also need to monitor the effectiveness of its new regime to ensure that its new approach does not dilute the high standards of performance, probity and accountability expected from the sector.

The Corporation's financial ratios provide a coherent and relatively robust way of identifying RSLs most at risk financially. Nonetheless, there is scope to improve the financial ratios so that they better deal with the key risks identified by RSLs, and this is set out in Part 4.

Diversification into new business activities has been taking place and appears set to continue. Although diversification might not yet be significant in financial terms, its novelty and the possibility of RSLs being less than fully prepared lend support to the Corporation's concern over the risks that it poses. The Corporation has recently introduced new measures to help it regulate diversification in individual RSLs.

We recommend that the Corporation:

- collate the information that it gathers about diversification in individual RSLs to arrive at a picture of how diversification is growing across the sector as a whole, the types of activities involved and the action taken to ensure that RSLs properly manage the attendant financial risks.

Part 3

Getting the right information

3.1 This Part of the report examines whether the Corporation has been effective in collecting and analysing information on the key financial risks faced by individual RSLs and the RSL sector as a whole. In particular, it examines whether the Corporation:

- collects appropriate information about individual RSLs (paragraphs 3.2 to 3.5);
- satisfies itself that RSLs' self-assessments are reliable (paragraphs 3.6 to 3.11);
- satisfies itself that RSLs' risk appraisals are of an appropriate quality (paragraphs 3.12 and 3.13);
- has a comprehensive view of the financial risks in the sector, using the information that RSLs provide (paragraphs 3.14 to 3.23); and
- meets its targets for regulatory activities (paragraphs 3.24 and 3.25).

Does the Corporation collect appropriate information about individual RSLs?

3.2 When assessing an RSL's performance, regulation staff are expected to assemble a comprehensive range of information. **Figure 9** shows the key sources of information at the Corporation's disposal.

3.3 There are, however, additional sources of information that would help the Corporation identify all of the key risks faced by RSLs. From our review of regulation files for the 20 RSLs that we visited, we concluded that there was scope for regulatory staff to:

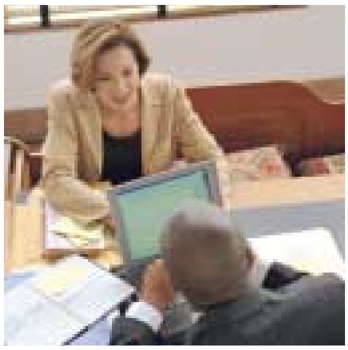
- consult with lenders and local authorities, particularly for RSLs that were developing properties using private finance or local authority grants;

9 **The Corporation's key sources of information**

The Corporation has an extensive range of information at its disposal to identify financial risk in individual RSLs.

RSLs are required to submit **annual statistical returns**[1] reporting their compliance with the Corporation's performance standards. Large RSLs, and RSLs that are developing properties, also provide quarterly financial returns.

Regulatory staff are expected to obtain **RSLs' key documents** such as annual reports and accounts, risk appraisals, management letters from external auditors, business plans and Board papers.



Regulatory staff in regional offices **visit** all large RSLs at regular intervals and maintain close contact with them to develop a better understanding of their business activities and the key financial risks that they face.

Note: 1. RSLs with less than 250 homes are covered by the Corporation's Regulatory Arrangements for Small Associations (the RASA regime), under which they are required to provide the Corporation with reduced versions of the annual statistical returns. Some 1,500 (70 per cent) of RSLs are covered by this regime.

Source: National Audit Office

- review RSLs' management accounts, which regulatory staff do not routinely obtain, but which we considered would be useful to them; and
- familiarise themselves with the main findings emerging from the work of RSLs' internal auditors and RSLs' internal audit plans to check the coverage of internal audit work. The Corporation is working with the RSL Internal Audit Forum to develop a protocol on what regulators should look at in respect of internal audit work.

3.4 These findings were consistent with the results of our survey. A sizeable proportion (28 per cent) of survey respondents disagreed or strongly disagreed that regulatory staff collected the right information. In addition, although RSLs welcomed the Corporation's introduction of lead regulation, they considered that it could be strengthened. They wanted to see more senior staff taking on the lead regulator role, with less experienced staff providing support, in an approach similar to the relationship between partners in large accountancy firms and their clients. In response, the Corporation has set up a central Lead Regulation Unit at its London headquarters to promote innovation and good practice in lead regulation and to lead regulate the 27 largest and most complex RSLs. The recent re-organisation of the Corporation will result in each of the four new Directors of Regulation having a team undertaking lead regulation.

3.5 In our 1993 report, *Housing Corporation: Financial Management of Housing Associations*, we noted that only about half of the associations submitted their audited financial statements to the Corporation on time. The Committee of Public Accounts recommended in their report of April 1994 that the Corporation should take firm action against defaulters. Further improvement is still required. The Corporation's regulation report for 1999-00 pointed out that, for that year, 33 per cent of RSLs had not submitted copies of their annual financial statements to the Corporation within six months of the required date. The Corporation told us that it received 98 per cent of all RSL accounts within a year of the required date, and that the great majority of the late accounts were from RSLs owning less than 250 homes. The Corporation also pointed out that court cases for non-submission of accounts had resulted in small fines, many of which the courts had not enforced, and had still not resulted in accounts being produced. The Corporation also told us that, as part of its submission to the 2000 quinquennial review by the Department, it had asked for more powers. Whilst it concluded that there was unlikely to be an early opportunity to change the legislation, the Department asked the Corporation to examine some of its proposals further. The Corporation is carrying out a review of the accounting requirements for small RSLs.

Summary and recommendation

The Corporation obtains regular and extensive information about the governance, finances and financial management of individual RSLs. However, there are additional sources of information that would help regulatory staff, while the identification of financial risks is hindered by some RSLs' late submission of their accounts. We recommend that the Corporation:

- ensure that regulatory staff assemble complete and timely information about RSLs' financial management and performance to help them reach the right regulatory judgements.

Has the Corporation satisfied itself that RSLs' self-assessments are reliable?

3.6 The regulatory regime depends in part upon RSLs self-certifying each year their compliance with performance standards. These standards require, for example, RSLs' governing bodies to exercise overall responsibility for their organisations' financial policies and control systems; RSLs to operate financial systems that provide effective control of their financial affairs; and RSLs to take a prudent approach in their financial management and planning and in managing financial and other risks. It is important that the standards are relevant and reliable indicators of RSLs' competence in governance and financial management. In our discussions with them, lenders expressed positive views about the purpose and content of the standards. **Figure 10** shows that the majority of RSLs responding to our survey were similarly supportive of the performance standards.

3.7 As **Figure 10** shows, 92 per cent of respondents agreed or strongly agreed that the standards were easy to understand. However, in 1999-00, some 45 per cent of the Corporation's 284 validation visits resulted in the RSLs being reclassified, mostly from satisfactory status (no problems identified) to observation status (cause for concern), although some were re-classified to supervision status (cause for serious concern). Around a quarter of reclassifications related to financial concerns, with most of the rest relating to tenant services. The percentage of RSLs reclassified in this way has increased since 1996-97.

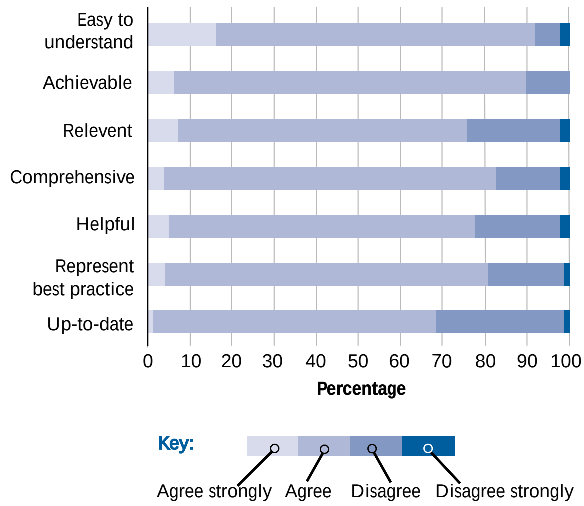
3.8 Not all of these reclassifications result from mis-certification. Validation visits may take place up to a year after RSLs have submitted their returns, during which time RSLs' performance might have deteriorated. The visits also involved more detailed scrutiny of RSLs' performance and went beyond the validation of the accuracy of RSLs' returns. Whilst the Corporation is able to assess in individual cases whether reclassifiction resulted from mis-certificiation or deterioration in performance with the passage of time, it does not collate this information. It is therefore not possible to draw firm conclusions on the reliability of RSLs' performance returns.

3.9 With the introduction of the new regulatory code in place of the performance standards, there will be less self-certification by RSLs. There will, instead, be a primary focus on outcomes, with provision for follow-up of cases where problems are identified or suspected. Against this background, the Corporation is considering the extent to which its programme of validation visits will continue in its current form.

10 RSLs' views on the Corporation's performance standards

The majority of respondents were positive about the Corporation's performance standards.

The Corporation's performance standard are:



Source: National Audit Office survey of RSLs

3.10 The Corporation requires RSL Boards to sign off their performance returns before submitting them to the Corporation. However, while RSL annual accounts are subject to external audit, the Corporation does not require RSLs to validate the information set out in their performance returns. At the 20 RSLs that we visited, RSLs had not sought to validate the returns they made to the Corporation. Our focus group of RSL internal auditors, drawn from the Housing Association Internal Audit Forum, confirmed that internal auditors were rarely called upon to validate the accuracy of RSLs' returns before they were sent to the Corporation.

3.11 Any weaknesses in self-certification might understate the extent of financial risk in the sector. Each year, validation visits by Corporation staff are undertaken for one-third of large and medium RSLs and one in ten small RSLs. These validation visits are not wholly random; regulators might select RSLs that they have concerns or suspicions about. The Corporation has access to information through lead regulation, financial review and the application of financial ratios that might highlight reasons why a validation visit should be undertaken. The Corporation considered that, as large RSLs received validation visits every three years and few such visits raised issues of serious financial concern, there was unlikely to be material under-reporting of serious problem cases. However, we were concerned that many RSLs listed as satisfactory might have warranted reclassification as observation or supervision cases, had they been visited and their returns been independently validated. The number of RSLs warranting observation or supervision might therefore have been higher than the 308 RSLs (14 per cent of RSLs) assessed as observation or supervision cases by the Corporation as at March 2000.

Summary and recommendation

The Corporation's performance standards on the governance and financial management of RSLs are highly regarded by lenders and RSLs. However, RSLs' self-certification of their compliance with these standards was not always reliable. None of the RSLs that we visited had validated the information provided in their performance returns. The Corporation is considering the extent to which its programme of validation visits will continue alongside its new regulatory code. We recommend that the Corporation:

- continue with a programme of visits to follow up cases where problems are identified or suspected, to assess RSLs' compliance with the new regulatory code.

Has the Corporation satisfied itself that RSLs' risk appraisals are of an appropriate quality?

3.12 The Corporation required large RSLs (with 250 or more homes) to submit their first risk appraisals by May 1999. The appraisals were expected to cover, as a minimum, the risks identified by the RSLs including any new risks, how the risks had changed over the previous 12 months and any changes to the management responsibility for the risks. In July 1999, we examined the risk appraisals of 42 RSLs across the Corporation's seven regional offices and found that they varied widely in their content. Some adopted a strategic approach, highlighting around a dozen key business risks, while others set out hundreds of risks in detail. Although 39 (93 per cent) of the appraisals identified key controls for mitigating identified risks, 13 (30 per cent) did not allocate responsibility for managing them. In addition, 17, (40 per cent) did not identify the likelihood of each risk materialising or its potential impact on the RSL.

3.13 The Corporation's guidance, *A Strategy for Success: Effective Risk and Business Management*, published in December 2000 pointed out that some RSLs had used the risk appraisal process effectively to identify risks but, in some cases, had lacked a strategic focus. Moreover, risk appraisal had often been a one-off project, rather than a tool to manage risk actively. The guidance identified the elements of a risk management framework for identifying and managing risk and encouraged RSLs to adopt that framework. In our view, there should be scope to build on this guidance and to bring a more consistent approach to RSL risk appraisals, based on best practices as they emerge and therefore help RSLs and the Corporation get the most out of the appraisals.

Summary and recommendations

Each large RSL has been required to undertake a risk appraisal identifying the risks that it faces and describing how those risks will be managed. However, the quality of some appraisals was variable. We recommend that the Corporation:

- continue to encourage RSLs to produce risk appraisals within a consistent framework to facilitate national and regional risk analyses; and
- monitor the quality of RSLs' risk appraisals to ensure that they have identified key risks and have adopted appropriate strategies for managing them.

Does the Corporation have a comprehensive view of the financial risks in the sector?

3.14 Risk management should begin with a comprehensive appraisal of the sources and nature of risk in the sector and an assessment of the likelihood of each risk maturing. In the case of the Corporation, such an appraisal should inform the design of its regulatory regime to ensure that it addresses the key risks in the sector, that is those risks that are the most likely to occur and that would cause most financial damage to RSLs if they materialised.

3.15 The Corporation has taken a number of steps to obtain information on some key aspects of the sector's finances, governance and financial management.

- In June 1998, the Corporation introduced a mandatory annual Private Finance Survey for all RSLs with 250 homes or more. The survey collects information on the main types and sources of RSL borrowing and their repayment schedules, as well as their forecast requirement for private finance over the following three years. The Corporation identified risks to the sector, including most RSL debt being concentrated in the hands of a small number of lenders. It now produces an annual bulletin, reporting on RSLs' private sector borrowing.
- In February 1999, the Corporation commissioned research into patterns of demand for social housing in response to growing evidence that many RSLs were finding it difficult to re-let properties in unpopular locations, putting at risk their rental income. The research, published in May 2000, developed indicators of low demand and estimated the impact of high levels of empty properties on RSLs' finances.
- The Corporation has also identified the emerging risks associated with the deterioration in the performance of RSLs against some of its key performance indicators.

3.16 The Corporation also produces RSL sector accounts, with the National Housing Federation, and financial performance indicators for the sector. It has also produced a sector-wide analysis of RSL, local authority and private sector Housing Benefit rents. However, the Corporation has not to date compiled a systematic or comprehensive appraisal of financial risk in the sector to inform the design of its regulatory regime. This analysis could draw on such key sources as:

- sector-wide accounts and the financial returns of individual RSLs, including quarterly returns and annual accounts;
- RSLs' performance returns; and
- RSLs' risk appraisals.

RSLs' financial returns

3.17 All RSLs are required to send copies of their audited annual accounts to the Corporation and, in addition, RSLs that are applying for development grants, Large Scale Voluntary Transfer RSLs and any problem RSLs are required to submit quarterly financial returns. Since 1994, the Corporation has stored data on key income and expenditure and balance sheet items from these returns and accounts in computerised databases. The Corporation, working with the National Housing Federation, used these data to produce brief summary analyses and sector-wide accounts for 1996-97, 1998-99 and 1999-00.

3.18 There is, however, scope for the Corporation to use its own data and the sector accounts more extensively, including monitoring trends at regional level. Where individual RSLs produce financial results that are substantially at variance with sector trends, the Corporation should assure itself that the RSLs are managing financial risks appropriately. The Corporation's new Financial Appraisal Teams will undertake such analysis. There is also scope for the Corporation, as the regulator, to provide better information to Parliament, the Department and RSLs on the financial health of the sector by producing an annual report on the sector's financial performance.

Such a report could provide information on the sector accounts, report the trends in RSLs' performance against the Corporation's financial ratios (along the lines shown in **Figure 6**) and describe any action taken by the Corporation to help RSLs manage their financial risks.

RSLs' performance returns

3.19 Although RSLs report annually on the extent to which they comply with the Corporation's performance standards, the Corporation has not analysed the results of these reports at regional or national levels. Such analysis would allow the Corporation to identify trends in the extent of compliance, whether RSLs are having common problems complying with particular standards, and help focus its regulatory activities.

3.20 As an example of the sort of analysis that might be possible, we looked at the largest RSLs' compliance in 1997-98 and 1998-99 with the Corporation's governance and financial management standards and those social housing standards that have a direct bearing on the financial health of RSLs - some 28 standards in all. In neither year did any RSL report that it met all of the standards; nor was any standard met by all RSLs. However, in general, the RSLs reported greater compliance with the standards, with the average reported compliance rate increasing from 91 per cent to 95 per cent over the period.

3.21 However, there were four key areas of reported non-compliance in 1998- 99:

- 21 per cent of RSLs reported that they had not complied with the standard that they should maximise the use of available housing stock by controlling the level of empty properties and maximise the collection of rent due;
- 13 per cent reported that they did not meet the requirement that they should make adequate financial provision for planned maintenance and improvement works;
- 13 per cent also reported that they had not met the standard requiring them to establish adequate policies and procedures to enable staff to raise concerns about propriety or probity in a confidential manner with the governing body or with a person delegated by the governing body; and
- 9 per cent reported that they had not complied with the requirement that they should take a prudent approach to financial management and planning, and to managing financial and other risks.

3.22 Again there is scope for the Corporation to undertake annually a high-level analysis with a view to reporting to Parliament, the Department and RSLs on how the sector has performed against the performance standards and on any specific action undertaken to improve performance against particular standards.

3.23 The Corporation is now working towards the development of a comprehensive view of the risks faced by the sector, based on the risk profiling work of its new Financial Appraisal Teams. It has also appointed a member of staff at headquarters to carry out studies on risks faced by the sector as a whole.

Summary and recommendations

The Corporation has examined some sector-wide risks, including risks associated with the use of private finance and changing patterns of housing demand. However, it has not yet assembled a comprehensive picture of financial risk in the sector. We recommend that the Corporation:

- undertake a systematic appraisal of the nature and extent of financial risks in the sector, drawing on RSLs' annual risk appraisals, research and periodic surveys, to help it better focus its regulatory efforts where there is the greatest financial risk; and
- provide an annual report on the financial health, governance and financial management of the sector derived from this analysis.

Does the Corporation meet its targets for regulatory activities?

3.24 The Corporation sets annual targets for delivering key regulatory activities involved in assessing financial risk, including reviews of the quarterly financial returns of large RSLs; reviews of the annual financial statements of all RSLs; and validation visits to a sample of RSLs to verify the accuracy of RSLs' performance returns **(Figure 11)**. It also sets out the number of investigation visits that it plans to carry out, although the actual number undertaken depends on whether the Corporation's initial reviews indicate that such investigations are necessary. These activities are intended to help detect actual or incipient difficulties in RSLs' finances, governance or financial management.

11 **The Corporation's performance against its regulation programme targets and plans, 1996-97 to 1999-00**

With the exception of validation visits, the Corporation met or nearly met its key regulatory targets over the four years 1996-97 to 1999-00.

Regulatory activity	1996-97		1997-98		1998-99		1999-00	
	Target	Percentage of target met	Target	Percentage of target met	Target	Percentage of target met	Target	Percentage of target met
Quarterly financial return reviews	2,443	97%	2,303	99%	2,197	97%	2,315	100%
Annual account reviews	2,334	102%	2,261	99%	2,131	99%	2,061	101%
Validation visits	176	96%	192	97%	267[1]	95%	284	98%
	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual
Investigation visits	382	457	430	403	336	365	212	237

Note: 1. Based on the aim of visiting one-third of large and medium sized RSLs each year to validate their returns, the Corporation should have set a target of 323 validation visits in 1998-99. However, due to workload pressures, the Corporation set the lower target of 267.

Source: Corporation's Regulation Programme progress reports

3.25 **Figure 11** shows that the Corporation has met or nearly met most of its regulatory targets. Starting in 1998-99, the Corporation has required its regulators to carry out a validation visit to all large and medium sized RSLs once every three years - that is, a third of them each year; and a visit to all small RSLs every 10 years. To achieve this, the Corporation needs to visit 323 RSLs a year. However, due to workload pressures, the Corporation set the lower target of 267 validation visits in 1998-99 and 284 in 1999-00. The Corporation actually carried out 254 validation visits in 1998-99 and 278 visits in 1999-00, a shortfall of 114 compared with the correct target of 646 over the two years. The Corporation will have to make good this shortfall and increase the number of validation visits that it carries out in 2000-01 if it is to meet its requirement that all large and medium sized RSLs should be subject to a validation visit over the three years 1998-99 to 2000-01. The Corporation is considering the extent to which validation visits will continue alongside the introduction of its new regulatory code.

Summary

Over the last four years, the Corporation has met, or nearly met, most of its annual targets for the delivery of key regulatory activities, although it incorrectly set its 1998-99 target for visits to verify the accuracy of RSLs' returns, leaving a backlog of visits to be completed in 2000-01. The Corporation is considering the extent to which validation will feature in the new regulatory regime.

Part 4

Reaching the right judgements

4.1 This Part examines whether the Corporation used the information it gathered to reach the right judgements about RSLs' finances, financial management and governance. In particular, it examines whether the Corporation:

- is appropriately staffed to regulate RSLs' management of financial risks (paragraphs 4.2 to 4.7);
- uses appropriate financial ratios to assess RSLs' financial health (paragraphs 4.8 to 4.14); and
- is effective in detecting financial problems in RSLs (paragraphs 4.15 to 4.20).

Is the Corporation appropriately staffed to regulate RSLs' management of financial risks?

4.2 A high proportion of regulatory staff time is devoted to assessing the information they receive about individual RSLs, and reaching judgements as to whether an RSL's performance is satisfactory, a cause for concern, or a serious cause for concern. These assessments determine the action to be taken in response, which is covered in Part 5. Any shortcomings in the quantity and quality of regulatory staff are likely to have an impact on the quality of those assessments, and the reliability of regulatory judgements.

4.3 Until recently, the Corporation's resources for financial regulation had not increased in line with the increase in its workload. Over the three years 1996-97 to 1998-99, the number of Corporation staff involved in financial regulation increased from 45 to 47; an increase of less than five per cent. However, in July 1999, a review commissioned by the Corporation estimated that its workload had risen by over 15 per cent over the same period. In response, the Corporation was allocated extra resources to recruit 15 qualified financial regulators. At March 2001, the Corporation had 58 staff dedicated to financial regulation.

4.4 Part 3 of this report showed that over the last four years the Corporation did not meet its targets for validation visits. The review of the Corporation's resources in July 1999 concluded the Corporation's expanding workload could already be seen to be having some adverse effects. These included:

- a 50 per cent decline in the number of supervision cases cleared up in 1998-99;
- a narrowing of focus in many investigation and validation visits;
- falling levels of resources employed on lead regulation; and
- less time spent on policy development, training and the sharing of good practices.

4.5 In the coming years, the sector is expected to continue to expand as a result of the Large Scale Voluntary Transfer programme. Registration of new RSLs created under this programme is likely to place increased demands on regulatory staff in all regional offices. The July 1999 review estimated that, with the growth in the transfer programme, the regulatory workload would increase by some 45 per cent up to 2004-05. The review concluded that efficiency savings could meet only around five per cent of this increase, leaving a potentially large gap between workload and available resources. The growth in the transfer programme, together with the demands of regulating an increasingly complex sector, will require the Corporation to ensure that its financial regulatory resources do not become over-stretched. The Department has recognised these pressures and has allocated additional monies to cover the Corporation's administration costs. These are expected to rise from £30 million in 1999-00 to £36 million in 2001-02, levelling off to £34 million in the two years to 2003-04. The Corporation told us that the re-organisation of its regulatory activities, particularly the increase in resources at senior level and the establishment of dedicated teams of regulators, has improved its ability to deal with the increasing workload arising from the growth in the Large Scale Voluntary Transfer programme and from the growing complexity of the sector. On average, each financial regulator in the Corporation's regional offices now oversees around 38 RSLs.

4.6 Respondents to our survey expressed concerns about the lack of skills and relevant business experience of regulation staff **(Figure 12)**. Thirty-six per cent of respondents disagreed or strongly disagreed that the Corporation had staff with the right skills regulating their organisations' businesses. Sixty per cent disagreed or strongly disagreed that the Corporation had staff with the necessary business experience to regulate their organisations' management of financial risk.

4.7 As more RSLs diversify and establish complex organisational structures and partnerships, the demands on the skills and knowledge of regulation staff are likely to increase. RSLs' treasury management and more complex financial reporting are two areas where the challenge of regulation might grow. The Corporation has recognised this and, since 1996, has been refining its staff training and development programme. In 1998, it identified the key skills required by regulation staff and carried out a skills audit to identify any gaps in staff skills. The skills audit identified the need for specialist finance knowledge in areas such as tax planning, treasury management and private finance. It also showed the need for regulation staff to have experience of housing management. In response, the Corporation put in place a training and development programme to improve staff skills. **Figure 13** shows that, in March 2001, most financial regulation staff in the Corporation's regional offices and in its headquarters had a professional qualification in finance. A minority had a recognised professional housing qualification or direct experience in housing management. As a result of its re-organisation, the Corporation has dedicated teams of financial regulators. It is also recruiting to its new inspection function staff with relevant housing qualifications and experience. The Corporation is also considering expanding its secondment scheme to encourage secondments to and from RSLs and other bodies involved in the social housing sector.

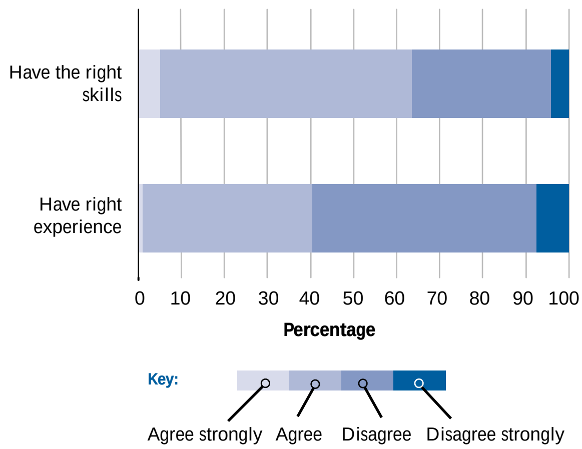
Summary and recommendations

The Corporation and the Department need to ensure that the Corporation's resources for financial regulation do not become over-stretched. A majority of RSLs considered that regulatory staff did not have the necessary business experience to regulate RSLs' management of financial risk. The Corporation is seeking to address these issues and we recommend that the Corporation:

- ensure that it commits sufficient resources to deliver its financial regulatory activities; and
- strengthen the skills and experience of its regulatory staff so that they may better regulate a growing and increasingly complex sector.

12 RSLs' views on the skills and business experience of regulation staff

A majority of respondents considered that Corporation staff did not have the necessary business experience to regulate the RSLs' management of financial risk.



Source: *National Audit Office survey of RSLs*

13 Percentages of regulatory staff with financial and housing qualifications or direct experience in housing management

A minority of regulation staff have professional qualifications in finance or housing, or direct housing management experience

Regulatory Staff	Percentage with a professional finance qualification	Pecentage that are members of the Chartered Institute of Housing (1)	Percentage with direct housing management experience
in regional offices	75	15	19
at headquarters	67	12	18

Notes: 1. Members of the Chartered Institute of Housing must have a recognised professional qualification and meet the Institute's professional practice requirements.

Source: *Housing Corporation*

Does the Corporation use appropriate financial ratios to assess RSLs' financial health?

4.8 The Corporation applies a set of financial ratios and benchmarks to an RSL's financial returns to help assess the RSL's financial health. We commissioned Standard & Poor's, a leading credit rating agency, to examine the adequacy of the ratios and benchmarks. Standard & Poor's considered that the ratios and benchmarks provided a coherent and relatively robust way of identifying those RSLs most at risk financially. The grading system was appropriate and its use to trigger more detailed enquiries was re-assuring. In relation to solvency and viability risk, the majority of the indicators were suitable. However, the benchmarks used for each ratio needed to be adjusted to reflect the overall business risks inherent in an RSL. And, some of the ratios needed to be modified and some new indicators introduced to take account of changes in RSL financial accounting and to make the ratios more appropriate (Appendix 5). Standard & Poor's made three main recommendations to improve the robustness of the indicators:

- an RSL with more aggressive development plans, lower demand for its properties and more unpredictable cash flows cannot afford to bear the same financial risk as a financially stronger RSL. The benchmarks that determine whether an RSL passes or fails a ratio should therefore be flexed up or down, depending on the RSL's business risks;
- three of the ratios should be replaced, two deleted and an additional two adopted to provide better measures of an RSL's financial health; and
- the ratio analysis should be supported by a wider range of analytical tools such as trend analysis, benchmarking and inter-regional comparisons in order to arrive at a more rounded judgement.

The Corporation set up a working group and consulted with lenders and the National Housing Federation to consider revising its financial ratios and benchmarks in response to these recommendations. The Corporation has changed some of the ratios along the lines recommended by Standard & Poor's and has appointed an external consultant to review the remaining recommendations.

4.9 We applied the new Standard & Poor's ratios to the latest available annual financial statements of 18 of the 20 RSLs that we visited. One of the other two RSLs was a new Large Scale Voluntary Transfer at the time of our examination and had only recently started operation, so had yet to produce its first set of accounts. The other RSL's latest set of accounts was for the year ending December 1997 and we therefore omitted this RSL from our analysis because the accounting information was dated. For the 18 cases we examined, the revised set of ratios confirmed the initial assessments produced by the Corporation's current financial ratios. However, they helped to identify issues that had not previously been identified or whose scale had not been fully detected by the existing ratios.

4.10 The revised ratios identified issues in five main areas **(Figure 14)**, of which the most common were the failure to identify or make adequate provision for major repair liabilities (eight RSLs) and the non-disclosure of interest capitalised (four RSLs). In each case, the issues identified could have a significant bearing on the RSLs' financial position.

4.11 The Corporation currently relies upon the discussions that take place between RSLs and lead regulators and on its business plan reviews to identify shortcomings in the provision for repair liabilities. One advantage of the ratio we propose is that it will identify cases where the stock is at risk of further deterioration through inadequate financial provision or lengthy repair programmes.

14 **Issues identified by the National Audit Office when applying the financial ratios recommended by Standard & Poor's to the annual financial statements of 18 RSLs**

The revised financial ratios recommended by Standard & Poor's helped to identify issues that had not previously been identified or whose materiality had not been fully detected by the existing ratios.

Issues identified	Number of RSLs where …		Impact
	the issue had not been identified	the materiality of the issue had not been fully detected by existing ratios	
RSL has not identified and/or made adequate provision for major repair liabilities[1]	2	8	Major repair liabilities either not quantified or not provided for
Interest capitalised but not disclosed in accounts	4	0	Financial statements did not disclose full interest paid and might have overstated operating surplus
After removing working capital distortions[2], RSL was generating insufficient cash to cover its operating activities	2	1	RSLs could not meet their interest and tax obligations from cash generated from their operating activities
Unacceptably large adverse variation between planned and actual net cash position after debt financing	2	0	RSLs' financial planning was an unreliable basis for managing the RSLs' business
RSL failed interest cover ratio when capitalised interest taken into account	1	0	RSL might face difficulties in repaying interest in future years

Notes: 1. The principal focus of the Corporation's financial ratios is to highlight short-term solvency issues, whereas the ratios recommended by Standard & Poor's would allow a view to be taken on longer-term financial management issues. The Corporation currently relies on its assessment of compliance against performance standards to pick up these issues.
2. Working capital distortions are caused by increases or decreases in the difference between current assets and current liabilities from one year to the next.

Source: National Audit Office

4.12 The non-disclosure of capitalised interest also poses a particular risk. Generally accepted accounting practice is to capitalise only those costs that are directly attributable either to RSLs' housing development programmes or to their activities in bringing properties into working condition; it does not allow for the capitalisation of interest on loans or draw-down facilities used by RSLs to support their business generally. The over-capitalisation of costs can mask poor trading results by overstating the operating surplus after tax and the value of fixed assets in the balance sheet. However, the Corporation does not check RSLs' annual financial statements to ensure that RSLs have disclosed their approach to the capitalisation of interest and other costs. Nor has it identified the extent of possible over-capitalisation by RSLs more generally. The Corporation relies on RSLs' external auditors, who are required to ensure the appropriate application of accounting standards for capitalisation, as it does for all accounting policies and standards.

4.13 In 1999, Bristol Churches Housing Association informed the Corporation that inappropriate capitalisation of its repair and interest costs had masked a serious deterioration in the RSL's financial position. Subsequent adjustment to its accounts revised the Association's trading results for 1997-98 from an operating surplus of £1.9 million to a deficit of £1 million. The RSL recognised that it could not trade out of its difficulties and the Corporation arranged a rescue through the merger of the RSL with a larger one. The Association had disclosed in its 1997-98 accounts that it had a policy of capitalising interest charges.

4.14 Our analysis of the accounts of the 20 RSLs we visited revealed that three RSLs had not disclosed the amount of capitalised interest in their accounts in 1997-98. We drew this problem to the Corporation's attention. In response, the Corporation included in its 1999 Accounting Determination for RSLs the requirement that RSLs provide an analysis of interest capitalised in their annual financial statements in future years. However, RSLs may also capitalise other expenditure items, such as development and repair costs, in addition to interest charges. The problem of non-disclosure, and possible inappropriate capitalisation of costs, might therefore be more widespread than our analysis suggests.

Summary and recommendations

The financial ratios and benchmarks used by the Corporation to assess RSLs' financial health provided a coherent and relatively robust way of identifying those RSLs most at risk financially. However, some of the ratios needed to be modified and some new indicators introduced. The Corporation has changed some, but not all, of the ratios and intends to commission an external consultant to review them. We recommend that the Corporation:

- reconsider the changes that it has made to its financial ratios and benchmarks, to bring them more into line with the recommendations made by Standard & Poor's, and increase the use of financial trend analysis, benchmarking and inter-regional comparisons; and
- carry out a review of RSLs' accounting policies and practices, possibly on a targeted sample basis, to assure itself that they comply with the 1999 Accounting Determination on capitalisation of interest.

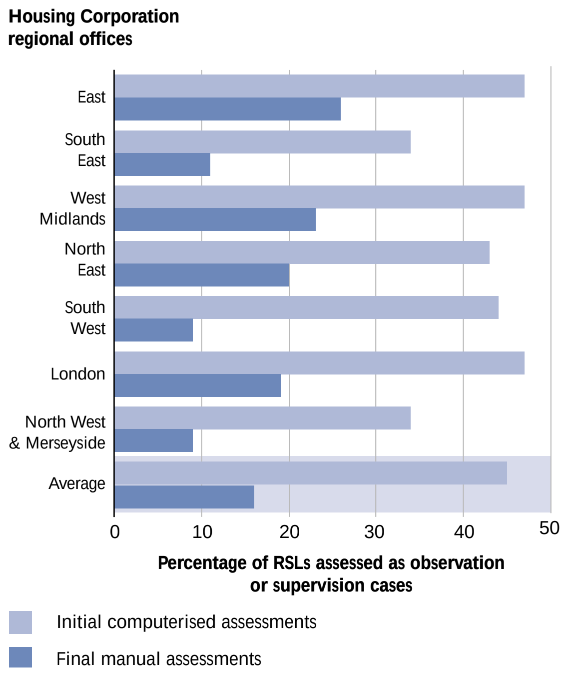
Is the Corporation effective in detecting financial problems in RSLs?

4.15 After generating initial computerised assessments of RSLs' finances, using the Corporation's financial ratios and benchmarks, regulation staff investigate further and use their own knowledge about an RSL to arrive at a final assessment. In line with Corporation guidance, regulatory staff routinely review the initial computerised assessments and re-assess RSLs from observation or supervision status to satisfactory status if there are no immediate issues of financial solvency.

4.16 The exercise of professional judgement is important to ensure that computerised results are subjected to proper scrutiny and that other relevant information not captured by the financial ratios is taken into account to arrive at a final assessment of an RSL's financial health. However, the re-assessment of RSLs by regulatory staff is common. **Figure 15** shows that, on average, 45 per cent of RSLs were initially assessed by computer as observation or supervision cases in 1999-00, but two out of three such cases were re-assessed as satisfactory by regulatory staff. There was also wide variation in the extent of re-assessments across the Corporation's regional offices; 44 per cent of initial observation or supervision assessments were re-assessed as satisfactory in the East region whereas 79 per cent of such cases were re-assessed as satisfactory in the South West region. The computer assessment is not made on the same basis as the manual assessment. The computerised assessment is based on RSLs' failures against financial ratios, and is

15 A regional office and national comparison between the percentages of RSLs[1] initially assessed as observation or supervision cases and then re-assessed as satisfactory cases

Regulatory staff routinely over-ride the initial computerised assessments of RSLs' finances, re-assessing them from observation or supervision status to satisfactory status.



Notes: 1. RSLs created under the Large Scale Voluntary Transfer programme fail most of the Corporation's financial ratios because of the way in which these RSLs are financially structured. We have therefore excluded these RSLs from the above analysis.

2. Data from around 29 large RSLs, representing around 12 per cent of the population, had not been finalised as at December 2000, and are omitted from one or more of these ratios.

Source: Housing Corporation financial ratio analysis of RSLs' 1990-00 annual accounts

used to prioritise RSLs for further review by regulatory staff. Regulators then assess whether the RSLs are likely to be insolvent or not financially viable over the following six to twelve months. The final, manual assessment is therefore likely to be different from the computerised assessment.

4.17 However, the Corporation has not systematically examined why so many RSLs are being re-assessed as satisfactory or why there is such inconsistency across the regions, although re-assessments have to be signed off by a senior regulator. It has set up a working group to produce guidance, aimed at improving consistency, and will be building a consistency review into its quality assurance programme.

4.18 We examined the re-assessment of 14 RSLs. Judgements in such cases are not straightforward and necessarily involve debate about whether problems might, if allowed to continue, lead to more serious difficulties in the future. We found that:

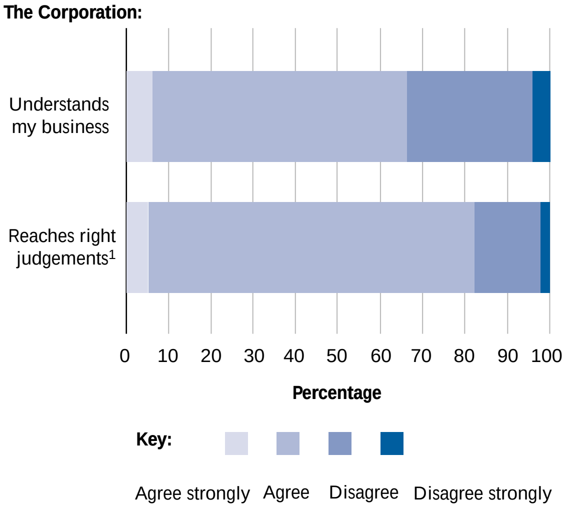
- regulatory staff had re-assessed RSLs as satisfactory where there were financial problems which they did not consider threatened the RSLs' short-term solvency, in accordance with Corporation guidance. However, by adopting this approach, regulatory staff allowed some longer-term financial risks to go unaddressed;
- regulatory staff focused on ratio failure and looked for compensating factors to off-set them, rather than investigating the causes of the failures and considering remedial action that could be taken;
- regulatory staff routinely accepted that RSLs had problems with rent arrears and Housing Benefit receipts, without considering whether the RSLs were taking action to address these problems, at least, to reduce their financial impact on the business; and
- the Corporation's financial ratio analysis was not appropriate for Large Scale Voluntary Transfer RSLs, where the structuring of the RSLs' finances meant that they automatically failed most of the ratios. Regulatory staff did not have any other tools to assess the financial performance of these RSLs other than comparing the RSLs' performance with its business plan and past performance. We considered that this was not enough to form a robust view on the financial strength of such RSLs. The Corporation intends to appoint consultants to help it devise new ratios for Large Scale Voluntary Transfer RSLs.

4.19 The Corporation told us that it took a risk-based approach to regulation, following up financial issues with RSLs depending on the materiality of the concerns. It aimed to identify those RSLs that had problems and then target its limited resources towards the most serious issues. This was an approach that the Corporation's new Financial Appraisal Teams would develop further through their risk management reviews. We agree that this is a sensible deployment of regulatory resources. However, it does leave many financial risks unaddressed and these could grow over time. The Corporation has not issued guidance on how its regulatory staff should view financial problems associated with rent arrears and Housing Benefit receipts and the extent to which these should be brought to the attention of RSLs. The Corporation pointed out that lead regulators would have a role in picking up on such issues for the largest RSLs. However, we consider that it would be prudent for the Corporation to communicate formally to RSLs all such issues so that RSLs are fully aware of them and may consider whether any action is required to prevent them from becoming more serious. The Corporation's approach is to communicate directly with RSLs on material issues. In the cases we looked at, however, regulatory assessments were not always communicated to the RSL concerned.

4.20 The majority of RSLs (82 per cent) we consulted considered that the Corporation reached the right regulatory assessments of their organisations and finances **(Figure 16)**. However, a significant minority of respondents disagreed or strongly disagreed that the Corporation understood the RSLs' business (34 per cent) or had reached the right judgements about their organisations' financial position, governance and financial management and management of risk (18 per cent). In their qualitative comments, respondents considered that the Corporation was better equipped to make assessments on governance issues than on finance issues, that more could be made of the financial data currently collected by the Corporation and that assessments would be enhanced through more frequent visits by the regulators to RSLs.

16 RSLs' views on the Corporation's regulatory assessments

Although the majority of respondents agreed or strongly agreed that the Corporation understood their business and had reached the right judgements, a significant minority disagreed or strongly disagreed.



Note: 1. "Reaches right judgements" is a composite of the responses about whether the Corporation reaches the right judgement on an RSL's financial position, governance and financial management and management of financial risk (see Appendix 6).

Source: *National Audit Office survey of RSLs*

Summary and recommendations

Regional offices manually re-assessed as satisfactory two out of three RSLs initially assessed as warranting observation or supervision. The Corporation has not issued guidance to its staff on how longer-term financial weaknesses should be viewed by regulatory staff and the extent to which the Corporation's concerns should be brought to the RSL's attention. While a majority of RSLs we consulted considered that the Corporation had reached the right regulatory assessments about their organisations' financial position, governance and financial management, a significant minority disagreed or strongly disagreed that this was the case.

We recommend that the Corporation:

- examine the reasons why so many of the computerised financial assessments of RSLs were over-ridden, and for the wide variation in the extent of re-assessments across regional offices;
- establish clearly defined criteria that must be met before regulatory staff may over-ride the results of the financial ratio analysis, and ensure that regulatory staff apply them consistently and document such decisions;
- develop appropriate tools to assess the financial performance of Large Scale Voluntary Transfer RSLs;
- bring to RSLs' attention underlying financial problems so that the RSLs are fully aware of them and may consider whether any action is required to prevent them from becoming more serious; and
- conduct regular reviews of regulatory assessments to ensure that there is consistency in classifying RSLs as satisfactory, observation or supervision cases.

Part 5

Acting on the results

5.1 This Part examines the Corporation's effectiveness in ensuring that problems are remedied and that lessons are learned both by regulatory staff and by RSLs. In particular, it examines whether the Corporation:

- handles problem cases well (paragraphs 5.2 to 5.6);
- has adequate statutory powers and uses them well (paragraphs 5.7 to 5.10);
- provides appropriate feedback to RSLs and other interested parties (paragraphs 5.11 to 5.15);
- seeks feedback from RSLs (paragraph 5.16); and
- is effective in identifying and disseminating lessons learned (paragraphs 5.17 to 5.20).

How well does the Corporation handle problem cases?

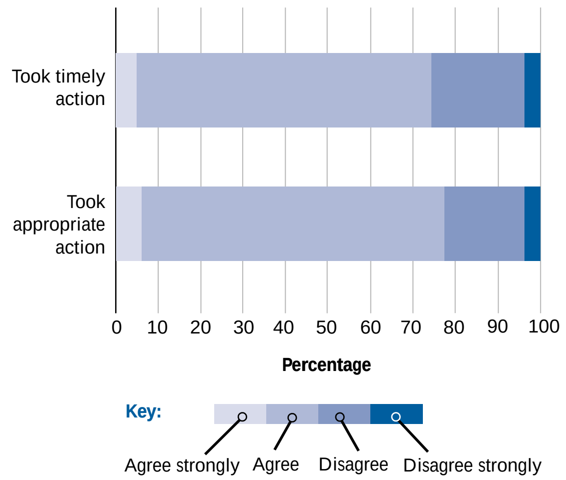
5.2 Lenders we consulted considered that, in general, the Corporation has been good at handling observation and supervision cases. And around four-fifths of the RSLs that responded to our survey agreed or strongly agreed that the Corporation took timely and appropriate action when problems emerged in their organisations **(Figure 17)**.

5.3 At the time of our review, over the period April to August 1999, the Corporation did not record information on observation cases in such a way as to make it easy to identify how long individual RSLs remained under observation. Consequently, we were unable to assess the longevity of observation cases. However, the Corporation now records the dates of such cases. It also records all supervision cases on a database. We used this database to assess how long it had taken to remedy the 42 supervision cases that were resolved between 1996-97 and 1998-99. The Corporation has not set corporate time limits within which supervision cases should be resolved. It does set target dates for the resolution of cases on an individual basis but these are flexible to take account of the circumstances of each case.

17 **RSLs' views on the timeliness and appropriateness of Corporation actions when problems emerge in RSLs**

Seventy-eight per cent of respondents agreed or strongly agreed that the Corporation took timely action when problems emerged in their organisation. In addition, 75 per cent of respondents agreed or strongly agreed that the Corporation took appropriate action.

The Corporation:

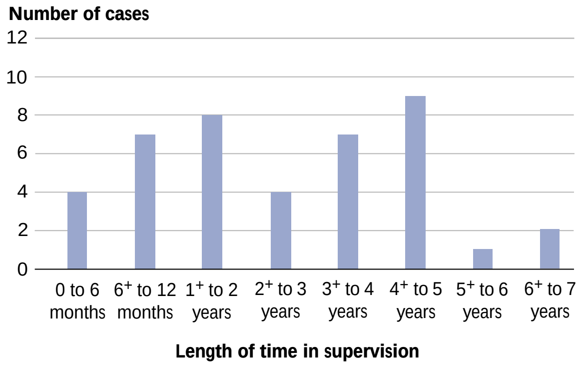


Source: National Audit Office survey of RSLs

5.4 Our analysis of the 42 resolved supervision cases showed that 23 (55 per cent) of these cases were in supervision for more than two years and 12 (28 per cent) for more than four years **(Figure 18)**. The overwhelming majority of these RSLs were in supervision because of governance, management, financial control or financial problems. The Corporation uses the term 'resolved' to denote when an RSL finally comes out of supervision but that, in almost all cases, this would be considerably later than when the main serious issues had been effectively dealt with. RSLs with serious problems remained under supervision while remedial action was given time to bed in. The Corporation told us that, where cases include the financial viability of RSLs, this aspect is given priority for early resolution.

18 **Analysis of the length of time RSLs had been under supervision**

Of the 42 supervision cases which were resolved between 1996-97 and 1998-99, 23 (55 per cent) had been in supervision for over two years, and 12 (28 per cent) for over four years.



Note: Includes RSLs under supervision for housing management issues and the standard of housing and housing services, as well as for financial issues.

Source: National Audit Office

5.5 At the time of our examination, the Corporation's quality assurance team had issued reports for four of the regional offices that they had visited as part of their 1998-99 programme. The team reviewed how well the four regional offices had handled, between them, 3 supervision cases, 19 observation cases and 11 recently resolved observation cases. The reports showed that much of the work was satisfactory. However, work on a small number of cases could have been improved through earlier identification, a more structured and rigorous approach in the early stages, regular review of strategies and more timely resolution. In 1999, a report, *Learning from Problem Cases*, commissioned by the Corporation highlighted that the Corporation did not have a consistent approach to the monitoring of supervision cases and that seven of the 17 cases examined should have taken less time to resolve.

5.6 We consider that the extent of recidivism amongst RSLs is a key measure of the effectiveness of the Corporation's remedial action. Recidivism would be measured as the number of RSLs that moved out of supervision or observation after remedial action had been taken but that had then reverted to supervision or observation status within the following two to three years. The Corporation does not consider that recidivism is a key measure of its regulatory performance and does not maintain or analyse such data. At the time of our review, its database did not provide sufficient information about the regulatory history of RSLs to allow us to assess the extent of recidivism amongst supervision cases. The Corporation has told us, however, that it now has the systems to track RSLs' movement into and out of supervision.

Summary and recommendations

Lenders and most RSLs considered that, in general, the Corporation has handled observation and supervision cases well. The Corporation has not set corporate time limits within which supervision cases should be resolved, although it does set target dates for the resolution of individual cases, which are flexible to take account of the circumstances of each case. However, some supervision cases run on for a long time. The Corporation does not analyse data on how long it takes to clear observation cases nor does it maintain or analyse information on the extent of recidivism. We recommend that the Corporation:

- establish corporate targets for the resolution of supervision and observation cases and monitor, record and report on progress to ensure that problem cases are resolved promptly; and
- monitor and report on the number of RSLs which are placed back in observation or supervision within three years of achieving satisfactory status.

Does the Corporation have adequate statutory powers and use them well?

5.7 Under the Housing Associations Act 1985 and the Housing Act 1996, the Corporation has a range of powers to regulate and supervise RSLs. A 1998 Order under the 1996 Act widened significantly the range of permissible purposes of RSLs, allowing them to diversify into new areas of business without any prior consent from the Corporation if these activities are within the RSLs' objectives. The Corporation's policy document, *Regulating A Diverse Sector*, issued in May 2000, aimed to safeguard the homes of social tenants as well as public investment in social housing by limiting the extent to which RSLs diversified into new business activities. The Corporation will be reviewing its policy in 2001. It will need to consider the extent to which its policy is supported by, and in line with, its statutory powers, lest it leave itself open to challenge by RSLs that are seeking to diversify more extensively into new business activities.

5.8 The Corporation applies various measures to secure effective remedy of problem cases. In some cases, bringing a problem to the attention of an RSL is sufficient to bring about the necessary improvements. In others, the Corporation uses some of its statutory powers to effect remedy. However, the Corporation relies mostly on persuasion and voluntary action to remedy any problems it detects, only using its statutory powers of intervention where it considers that these are appropriate to the seriousness and materiality of individual cases.

5.9 **Figure 19** shows that, in the past four years, the Corporation has used its powers on 102 occasions to effect remedy of RSLs' problems. The Corporation's most frequently used powers have been grant-related; to withhold capital development funding from RSLs under supervision until they have taken remedial action, and to reject bids from RSLs under supervision for development grants for future years. The Corporation pointed out that its powers are not available or appropriate in every case. Their use very much depends on the nature and the severity of the cases at hand. The Corporation reserves some other powers, such as appointing new Board members or instigating a Statutory Inquiry, for the most serious cases. In September 2000, the Corporation started two statutory inquiries, one into Liver Housing Association, and the other into Clays Lane Housing Co-operative. The Corporation last used these powers in 1992.

5.10 The Corporation reviewed the use of its supervisory powers, following the report, *Learning from Problem Cases*, in 1999. It also put proposals for strengthening its powers to the Department during the quinquennial review in 2000. Whilst it concluded that there was unlikely to be an early opportunity to change the legislation, the Department asked the Corporation to examine some of its proposals further. With over half of supervision cases taking more than two years to resolve, there is a case for the Corporation to commission further research to evaluate which powers and regulatory measures are most effective in bringing about timely and lasting remedy and under what circumstances.

19 **Powers used by the Corporation to remedy RSL problem cases, April 1997 to March 2001**

In the four years to March 2001, the Corporation used its powers on 102 occasions to remedy supervision cases.

Powers used	Number of times used 1997 to 2001
Requiring corrective action before starting to pay approved development grants	47
Rejecting bids for development grants in subsequent years	21
Appointing new members to an RSL's Board	21
Facilitating a rescue of one RSL by another where an RSL is threatened with insolvency	13
TOTAL	**102**

Source: Housing Corporation

Summary and recommendations:

The Corporation has a range of powers to regulate risk in RSLs, although its statutory powers are limited in the area of regulating diversification. The Corporation has generally preferred to work through persuasion and voluntary action on the part of RSLs, rather than invoke its powers, to remedy problem cases. We recommend that the Corporation:

- in reviewing its policy on regulating RSL diversification, consider the extent to which its policy is supported by, and in line with, its statutory powers; and
- commission research into the effectiveness of the different powers that it has at its disposal, following up the recommendations from the 2000 quinquennial review.

Does the Corporation provide sufficient feedback to RSLs and other interested parties?

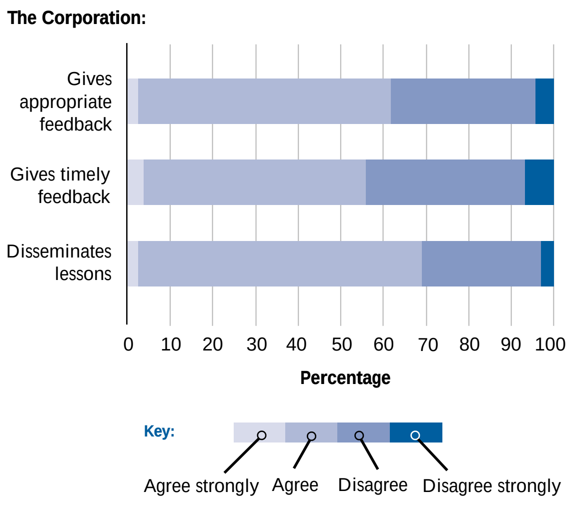
5.11 For RSLs to benefit from the Corporation's regulatory activities, it is important that they receive appropriate and timely feedback on their performance. The Corporation publishes a range of information that comes out of its regulatory activities. This includes an annual report on how all large and medium-sized RSLs have performed against the Corporation's key performance measures and an annual regulation report summarising some of the key issues arising from its regulatory reviews.

5.12 However, there is scope to provide better feedback to individual RSLs. At the 20 RSLs we visited, there was common concern that the Corporation did not provide RSLs with appropriate and timely feedback following investigation and validation visits. Our survey also revealed that a substantial number of RSLs were not satisfied with the feedback provided by the Corporation **(Figure 20)**. Some 38 per cent of respondents disagreed or strongly disagreed that the Corporation provided their organisations with appropriate feedback, while 44 per cent disagreed or strongly disagreed that feedback was timely.

5.13 The Corporation has not issued any guidance to RSLs explaining its financial ratios and benchmarks and how they are used to assess RSLs' solvency and financial viability. None of the 20 RSLs that we visited had a clear understanding of the ratios or of how the Corporation arrived at its financial assessments. Nor had they been made aware of how they had performed against the financial ratios. The Corporation has since consulted with the National Housing Federation in revising its financial ratios and now intends to issue guidance to RSLs once it has finalised them.

20 RSLs' views on feedback provided by the Corporation

Although two-thirds of RSLs were content with the feedback they received from the Corporation, one-third were not.



Source: National Audit Office survey of RSLs

5.14 Each year, the Corporation publishes data showing RSLs' performance against a range of indicators. However, RSLs, lenders and local authorities would like to see more information made available. Lenders considered that the results of investigation and validation visits should be put into the public domain. Local authorities wanted the Corporation to notify them of regulatory concerns about RSLs in their areas and suggested that RSL performance information be published by local authority area. The Corporation has established a protocol through which it will share with local authorities information about RSLs. It is developing a similar protocol for lenders. It has also recently launched a pilot exercise to improve the quality and scope of its reports on RSL performance and increase the transparency of its regulatory assessments and investment decisions. It will publish on its Internet website documents from the pilot exercise. This will be the first time that it will have made regulatory assessments and investment decisions publicly available. It expects this to be the starting point for the development of a public statement of its regulatory assessments of individual RSLs.

5.15 Inspection and regulation regimes elsewhere in the public sector include oral presentations of inspectors' or regulators' main findings upon completion of field visits. These are then followed by a written report within a specified period after a visit has taken place. Typically, the resultant inspection reports are then published and made publicly available. There is also usually an appeals procedure if the body concerned is not satisfied with the regulatory assessment or the way in which it has been treated during a visit. The Corporation told us that regulatory staff provide feedback after visiting RSLs and that there are procedures which set a timetable for issuing reports. The Corporation has a commitment to make public all Inspection reports when its new Inspection function starts in autumn 2001.

Summary and recommendations:

Although the Corporation publishes a range of information that results from its regulatory activities, there is scope for the Corporation to improve its feedback to RSLs. The Corporation has not explained its financial ratios and benchmarks to RSLs, how they are used or how RSLs have performed against them, although it has consulted with the National Housing Federation in revising its financial ratios and now intends to issue guidance to RSLs once it has finalised them. RSLs expressed concern that they were not provided with appropriate and timely feedback following investigation and validation visits. Lenders and local authorities want the Corporation to put more RSL information in the public domain. We recommend that the Corporation:

- provide guidance to RSLs on the financial ratios that it uses to assess RSLs' solvency and financial viability, including how they are applied;
- establish clearly defined feedback procedures, including standards for the type and timing of feedback, to ensure that all RSLs are provided with timely and appropriate feedback on the results of regulatory reviews and visits; and
- push on with its pilot exercise publicising its regulatory assessments of RSLs so that the information is put into the public domain as soon as possible for the benefit of all of the stakeholders in the sector.

Does the Corporation regularly seek feedback from RSLs?

5.16 The Corporation regularly seeks feedback from the sector before it introduces changes to the regulatory regime, and as changes are implemented. For example, the Corporation consulted widely when introducing lead regulation. However, as well as seeking feedback on new regulatory initiatives, it is important that regulators seek on-going feedback from the regulated. Feedback should be sought on how the overall regime can be made more effective and efficient and also on the operations of each element of the regulatory framework, including the extent to which individual RSLs consider that regulatory visits have been carried out courteously, efficiently and to a high professional standard. While the Corporation has well established links with the sector and with the relevant professional associations and publishes an annual regulation report, it does not routinely and systematically seek feedback from RSLs on its overall performance as a regulator. The Corporation will be implementing independent, biennial reviews of its regulatory performance, taking into account RSLs' and stakeholders' views.

Summary and recommendation:

The Corporation does not routinely or systematically seek feedback from RSLs on its overall performance as a regulator. We recommend that the Corporation:

- regularly seek feedback from RSLs on how the overall regulatory regime can be made more effective and efficient as well as on the operation of each constituent part of the regime, including the extent to which individual RSLs consider that regulatory visits have been carried out efficiently and to a high professional standard.

Is the Corporation effective in identifying and disseminating lessons learned?

Lessons for regulatory staff

5.17 It is important that regulatory staff have an opportunity to learn lessons from the activities of their colleagues; particularly from those operating in other regions. The Corporation told us that it has held seminars on key issues for regulatory staff as part of a "roadshow" visiting each regional office every six months over the last two years. In April 1998, the Corporation launched a new quality assurance programme, with the aim of ensuring that the regulation regime was being implemented consistently across England, that regulatory judgements were soundly based and appropriate and that good practice was being shared between regional offices. In 2000-01, the team of six quality assurance staff visited all seven regional offices and examined a total of 28 observation cases (12 per cent) and the on-going regulation of 68 large RSLs (28 per cent). We considered that these were good levels of coverage for the quality assurance programme.

5.18 Each visit resulted in a report to the relevant regional office, identifying scope for improvements at the regional level. Where relevant, the quality assurance reports noted changes needed to national systems or procedures. In particular, they highlighted lessons to be learned in handling and progressing observation and supervision cases and the need for more consistent financial monitoring of newly registered Large Scale Voluntary Transfer RSLs during the first two years of operation. The quality assurance team produced a report for the Corporation's Registration and Supervision Committee, summarising their key findings. The quality assurance system is in its infancy and is still evolving and there is a need to place more emphasis on the identification of good regulatory practice. It could also be improved by including an examination of how well regulatory staff provided feedback to RSLs. The Corporation might also consider how the results of the quality assurance reviews can be better shared throughout the Corporation and also with RSLs.

Lessons for RSLs

5.19 The Corporation is uniquely placed to identify good practice in managing financial risk in social housing and it is important that this is shared with RSLs. The 1999 report *Learning from Problem Cases*, examined the regulation of 17 RSLs that had been under supervision in recent years, in order to learn lessons, and made wide-ranging suggestions for improvements to the Corporation's regulatory regime including the need for the Corporation to:

- take a more analytical role in identifying problems, providing RSLs with early warning of potential areas of weakness and disseminating good practice;
- seek independent certification where the Corporation has concerns about the quality of an RSL's financial management or its potential financial viability;
- draw up contingency plans, when putting in place a rescue strategy for a failing RSL, in case the rescue strategy does not succeed; and
- undertake a short post mortem on all supervision cases referred to the Registration and Supervision Committee.

5.20 The Corporation drew up an action plan and organised seminars for its regional staff to take forward the report's findings and recommendations. Many respondents to our survey mentioned this report as a good example of how the Corporation should disseminate information to help regional offices and RSLs respectively improve their regulation and management of financial risk. They suggested that the Corporation should take a more proactive role in disseminating lessons learned from its regulatory activities and produce more such reports. Examples would be the two briefing supplements on rents that the Corporation has published.

Summary and recommendation:

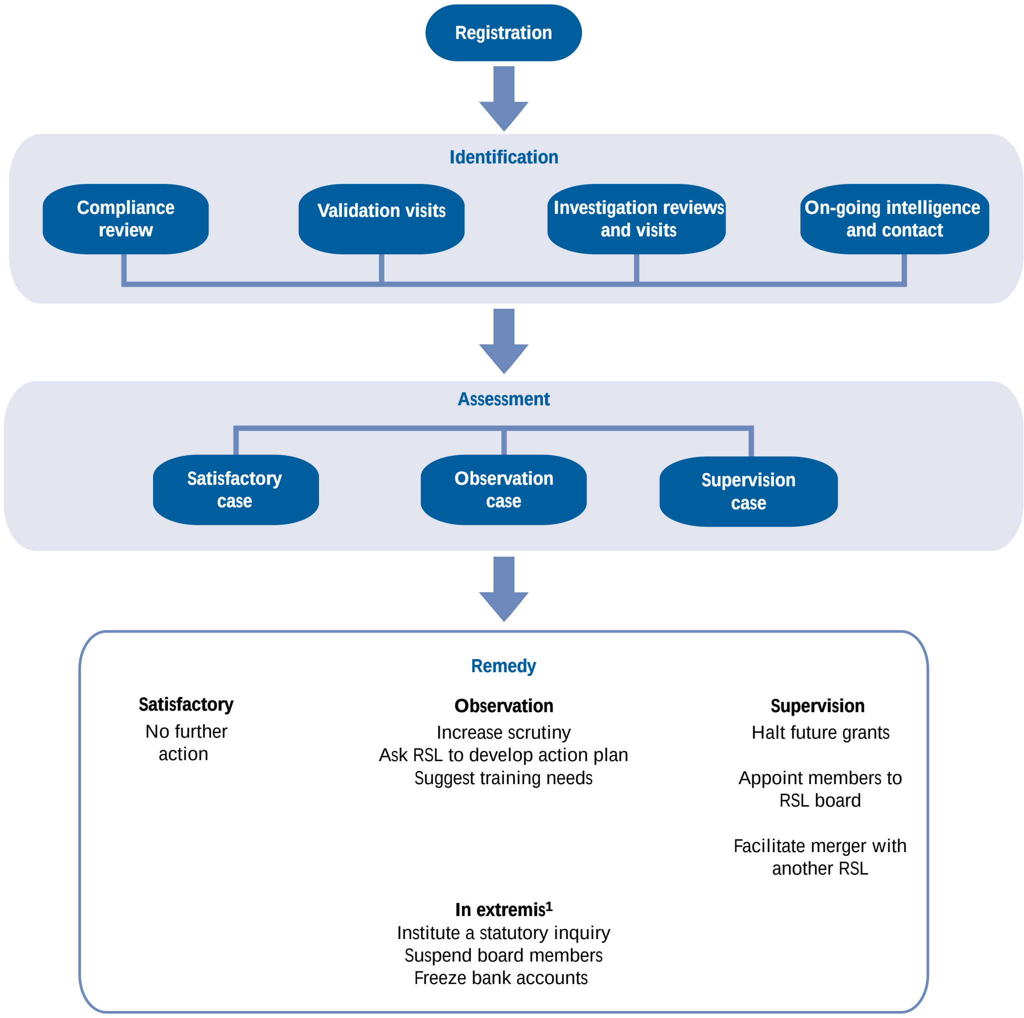
The Corporation's new quality assurance programme could be extended to cover how well regulatory staff provide feedback to RSLs, and the programme's results disseminated more widely. RSLs suggested that the Corporation should take a more proactive role in disseminating lessons learned from its regulatory activities. We recommend that the Corporation:

- take further action, particularly through its quality assurance programme, to identify and disseminate good practice across its regional offices and among RSLs.

Appendix 1 Key stages in the Corporation's regulation of RSLs' management of financial risks

Until recently, there were three key stages in the Corporation's regulation of RSLs' management of financial risks: identification, assessment and remedy.

The Corporation's regulatory regime was designed to identify and assess financial risks and ensure that RSLs remedy any weaknesses.



Note 1. The Corporation is most likely to apply the most extreme measures in supervision cases, although such measures might be necessary in response to a rapid deterioration in the performance of a satisfactory RSL or an RSL under observation.

Source: *National Audit Office*

Identification

Accounts information

All RSLs periodically send the Corporation's regional offices key financial and management documents such as business plans, annual reports and audited financial statements, together with external auditors' management letters. Large RSLs, with over 1,000 homes, medium-sized RSLs, with between 250 and 1,000 homes, and RSLs in receipt of Corporation development grant are also required to submit quarterly financial statements and three-year financial forecasts signed off by their boards. In 1993, the Corporation introduced a system of desktop reviews of all RSLs, assessing their financial position against a range of financial (FISS) ratios and benchmarks. The Corporation applies its financial ratios and benchmarks to these annual and quarterly financial statements and draws attention to existing or potential problems.

Performance information

Large and medium-sized RSLs also submit a detailed annual statistical return containing information, for example, about void rates and numbers of lettings, and a self-assessment of the extent to which they meet the Corporation's performance standards. Small RSLs, with less than 250 homes, submit reduced versions of this return under the Corporation's Regulatory Arrangements for Small Associations regime. In addition, regional offices nominate their senior staff as lead regulators to develop closer ties with the largest RSLs.

Validation visits

Much of the regulatory regime relies on RSLs self-certifying their performance against the Corporation's performance standards. The Corporation therefore requires regional office staff to carry out validation visits to verify the accuracy of an RSL's self-assessment return. Large and medium-sized RSLs should be visited every three years and small RSLs once every ten years. The Corporation treats as a supervision case any RSL that knowingly provides it with false information.

Assessment

Initial assessment

Regulation staff review the information collected from RSLs, plus the computerised analysis of the financial data and feedback from other key stakeholders such as local authorities and lenders. They arrive at two assessments: one for governance and financial management and the other for financial solvency and viability. On the basis of these assessments, RSLs were given a provisional grading:

- satisfactory - no problems identified;
- observation or cause for concern - such a case might involve concerns about an RSL's finances or compliance with standards, but which are not critical to its financial solvency or viability; or
- supervision or cause for serious concern - this might involve widespread non-compliance with the Corporation's standards, absence of financial control, threat of insolvency or major fraud.

Further investigation

If weaknesses are identified, then further investigatory work is carried out, including a possible visit to the RSL and a final grade is then established. For an observation case, the Corporation exchanges correspondence with, or visits, the RSL to require the rectification of the identified problems or deficiencies. For a supervision case, the Corporation subjects the RSL to close scrutiny. It visits the RSL to investigate further, draws up a detailed action plan for remedying the problems or deficiencies and requires a formal response from the RSL's board. In observation and supervision cases, the Corporation monitors the corrective action taken.

Remedy

In placing RSLs under observation and supervision, the Corporation may take action to encourage them to remedy problems or may intervene directly to strengthen their governance and management. The Corporation has a considerable range of options and powers it can exercise to bring about needed improvements. These include: requiring corrective action before starting to pay approved development grants; appointing or removing an RSL's board members; or facilitating, with the consent of any secured creditors, a rescue of one RSL by another where an RSL is threatened with insolvency.

Appendix 2

Response to the 1994 report of the Committee of Public Accounts

Committee's conclusions and recommendations (20th Report 1993-94, HC 204)	Treasury Minute response (CM 2602, 1993-94)	Further action taken by the Corporation
Regulatory Coverage		
The Corporation should address the frequency of its coverage, especially in relation to small and medium-sized RSLs.	The Corporation has introduced a programme to expand its coverage, phased in over three years. It aims to carry out annual assessment of returns from all RSLs and follow up with investigative work where required.	The Corporation now carries out annual compliance reviews of all RSLs. Additional information, such as quarterly returns and annual risk appraisals, are required from larger RSLs or those that have performed poorly in the past.
Financial Assessment		
With about half of RSLs failing to submit audited accounts on time, the Corporation should take firm action against defaulters.	The Corporation continued to monitor the position closely and take firm action, including prosecution, to deal with defaulters. By late 1993, only seven per cent of RSLs were late and these were predominantly very small RSLs.	The Corporation now makes all defaulters "supervision" cases. Non-submission of two quarterly returns results in a funding freeze.
The Corporation should improve its scrutiny of management letters provided by RSLs' auditors and encourage better use of the external audit function.	The Corporation was updating its Code of Audit Practice, and issued additional guidance in March 1994. It already assessed RSLs' management letters along with audited accounts.	The Corporation now grades management letters in tandem with its ratio analysis of annual accounts.
The Corporation should take a longer-term view of RSLs' financial standing.	The April 1994 performance standards required all RSLs to ensure that they had viable plans. Large and medium-sized RSLs were required to submit annually a three-year business plan.	Smaller RSLs that are bidding for development funding must also submit business plans. The Corporation examines the contents of these plans using the same ratio analysis as that used for other financial statements.
Financial Management		
The Corporation should ensure that RSLs have the resources and experience to manage private sector borrowing satisfactorily.	The Corporation had carried out a study of the treasury management function within RSLs and was taking forward the findings.	The Corporation now has a performance standard on treasury management. It has issued guidance to assist RSLs that intend to apply for permission to use financial derivatives.
The Corporation should issue firm guidelines on the need for, and operation of, internal audit.	The Corporation issued a circular setting out its requirements on internal controls.	The Corporation has further developed its Code of Audit Practice, which all internal audit functions should meet.

Committee's conclusions and recommendations (20th Report 1993-94, HC 204)	Treasury Minute response (CM 2602, 1993-94)	Further action taken by the Corporation
The Corporation should give close attention to the risk of fraud and irregularity.	When advised of any fraud or irregularity, the Corporation took immediate steps to ensure that the underlying weaknesses were addressed.	The Corporation now requires RSLs to register all incidents of actual or attempted fraud. Frauds in excess of £1,000 must be reported to the relevant Regional Director, as must any fraud perpetrated by a member of the governing body or senior RSL member.
Performance Reporting		
The Corporation should take steps to publish performance data so that the respective performance of different RSLs can be compared.	The Corporation was due to issue proposals for the publication of a set of indicators relating to the service provided to RSLs' tenants.	The Corporation now publishes Performance Indicators (PIs) for the 370 RSLs that own over 250 homes and/or are actively developing. It has also developed proposals for PIs and performance reporting by RSLs in response to the government's Best Value initiative.
Regulatory powers		
The Corporation's statutory powers should be developed and strengthened where necessary, especially in areas such as: access to RSLs' unregistered subsidiaries; and measures for tackling problem RSLs.	The Corporation had identified some aspects of its regime that it considered might be improved, to make it easier to take supervisory action in some circumstances and to obtain systematic information about the unregistered subsidiaries of registered bodies.	The Housing Act 1996 gave the Corporation several additional powers, including those to call for information from unregistered subsidiaries.

Appendix 3 Study methodology

Method	Purpose	Methodological note
Interviews and file reviews at the Corporation's headquarters and at five regional offices	To evaluate the Corporation's regulatory systems, resources and working practices and to examine regulation files and interview regulatory staff about 20 RSLs that we selected as case studies plus the Corporation's files on supervision cases.	In depth at three regions of the Corporation's seven regions - London, West Midlands and the North West & Merseyside plus familiarisation visits to three regions South West, South East, and North West. The selected cases included 15 large or medium-sized RSLs that the Corporation had classified as satisfactory cases in its most recent regulatory assessments and five large or medium RSLs that were observation cases. We focused on larger RSLs and sought to examine a mix including RSLs in group structures, RSLs which were still developing or diversifying into new activities and RSLs which were the result of Large Scale Voluntary Transfers.
Interviews and document reviews at 20 large RSLs	To establish whether the Corporation had arrived at sound judgements on the financial performance, governance and management of the sampled RSLs and to ascertain RSLs' views on the Corporation's regulatory regime and activities.	Interviews were conducted with Chief Executive Officers, Finance Directors and other senior RSL staff - including internal auditors. We were assisted with the analysis and interviews by a senior consultant from HACAS Ltd, specialists in housing finance and management.
Postal survey of RSLs	To gather views on the Corporation's regulation of RSLs' management of financial risk and to ascertain the nature and extent of new business activities and new organisational structures adopted or planned by RSLs, their impact on financial risk and the action taken by RSLs to manage the attendant financial risks.	210 RSLs, 30 in each of the Corporation's seven regions, were surveyed. Since the most material financial risks lie with the largest RSLs, we sent the questionnaire to 112 large RSLs, 63 medium-sized RSLs and 35 small RSLs. The questionnaire was developed and pilot tested in conjunction with the Corporation and the National Housing Federation. The response rate was just over 80 per cent. A breakdown of responses to the survey is at Appendix 6.
Review of the Corporation's financial ratios	To review the appropriateness of the financial ratios and benchmarks that the Corporation used to assess RSLs' solvency and financial viability.	Standard and Poor's, a major credit rating agency with experience of the RSL sector, were commissioned to undertake the review.
Review of the RSL risk appraisals	To assess whether the RSLs had complied with the Corporation's requirements and to identify RSLs' assessments of the nature and extent of the financial risks that they face.	We selected for review the risk appraisals of the 20 RSLs that we had visited, together with another 10 chosen at random from each of the Corporation's London, North West & Merseyside and West Midlands regions, bringing the total to 50. However, eight of the RSLs concerned had not produced a risk appraisal at the time of our review. We therefore reviewed the 42 that were available.
Analysis of the Corporation's regulatory databases	To assess what data are collected and how they are managed and utilised; and also to assess what the data show about the regulatory activities and performance of the Corporation.	At its headquarters in London, the Corporation maintains several computerised databases which hold an extensive range of data on RSLs' financial statements and RSLs' performance against the Corporation's financial (FISS) ratios and benchmarks and performance standards.
Analysis of the Corporation's supervision database	To establish the quality and utility of the information held on the database and to obtain data on the number, type and longevity of supervision cases over recent years.	We selected 10 cases for detailed review, examining in particular the timeliness with which problems were identified and resolved.
Interviews with leading financial institutions and other key stakeholders	To establish their views on the extent of financial risk in the sector and the impact of the Corporation's regulatory work.	We interviewed eight leading financial institutions with total loans to the sector in excess of £12.5 billion plus other key stakeholders with an interest in the sector.
Review of housing legislation	To assess whether the Corporation's statutory role and powers are clearly defined and sufficient to allow for effective regulation of the RSL sector.	The Housing Corporation's statutory role and powers are set out in four key pieces of housing legislation: the Housing Act 1974, the Housing Associations Act 1985 and the Housing Acts 1988 and 1996.
Focus group of RSL internal auditors	To ascertain their responsibilities and their experience of dealing with regulatory staff from the Corporation.	We met with seven internal auditors who were all members of the Housing Association Internal Audit Forum.

RSLs visited

Ashton Pioneer Homes Limited

Bradford & Northern Housing Association Limited

Caldmore Area Housing Association Limited

Co-operative Home Services (Home Counties) Limited

Elgar Housing Association Limited

The Friendship Group

Manchester Methodist Housing Association Limited

Moseley & District Churches Housing Association Limited

Network Housing Association Limited

Northern Counties Housing Association Limited

Octavia Hill Housing Trust

St Vincent's Housing Association Limited

South London Family Housing Association Limited

Touchstone Housing Association Limited

Ujima Housing Association Limited

The Villages Housing Association Limited

West Hampstead Housing Association Limited

Western Challenge Housing Association Limited

The William Sutton Trust

Wyre Housing Association Limited

Stakeholders interviewed

Abbey National plc

Barclays Bank plc

Bradford & Bingley Building Society

Charity Commission

Chartered Institute of Housing

Council of Mortgage Lenders

Dexia Municipal Bank

Halifax plc

H M Treasury

Housing Finance Corporation

Industrial & Provident Society

Local Government Association

National Housing Federation

Nationwide Building Society

NatWest plc

Advisory Panel

To provide us with an independent and authoritative view on the scope, methodologies and findings of the study, we set up an advisory panel consisting of people who had extensive knowledge of the social housing sector. The panel consisted of:

- Patricia Day, Senior Research Fellow, School of Social and Policy Sciences, University of Bath
- David Gleave, Head of Housing Associations and Private Finance Branch, Department of the Environment, Transport and the Regions
- Tim Jackson, Assistant Director of Regulation, the Housing Corporation
- Caroline Shah, Business Analyst
- Colin Sherriff, Chief Executive, Parkside Housing Group
- James Tickell, Assistant Chief Executive, National Housing Federation
- Don Wood, Chief Executive, London & Quadrant Housing Trust

Appendix 4 Comparisons of main items in the RSL sector accounts

Comparison of the main balance sheet items as at 31 March 2000 and 31 March 1996

Over the period March 1996 to March 2000, the sector's balance sheet has strengthened, with the combined value of fixed assets, reserves and surpluses increasing by more than the increase in the value of long-term loans.

Balance sheet items	As at 31 March 2000 £m		As at 31 March 1996 £m		Percentage Increase or (decrease)
Net fixed assets[1]		23,565		13,604	73
Current assets	2,581		2,255		14
Less current liabilities:					
Short-term loans	(259)		(136)		90
Bank overdrafts	(39)		(55)		(29)
Other current liabilities	(1,472)		(1,031)		43
Total current liabilities	(1,770)		(1,222)		45
Net current assets		811		1,033	(21)
Total assets		**24,376**		**14,637**	
Financed by:					
Long-term loans	(15,169)		(8,907)		70
Long-term creditors	(297)		(225)		32
Reserves and surpluses	(8,910)		(5,504)		62
Total loans, reserves and surpluses		**24,376**		**14,636**[2]	

Notes: 1. Most RSLs value their fixed assets at historic cost in their balance sheets, although some might use current market valuations. The amount shown is net of Corporation grants.

2. Difference of £1 million due to rounding.

Source: National Audit Office, using Housing Corporation data

Comparison of the main income and expenditure items for the sector as a whole 1999-00 and 1995-96

Although income has increased, costs have increased by more, particularly interest payable, leading to a reduction in surpluses after tax.

Income and expenditure items	1999-00 £m		1995-96 £m		Percentage increase or (decrease)
Total income from letting		4,585		3,013	52
Letting and other costs		3,393		2,017	68
Operating surplus		1,192		996	20
Surplus after tax, the calculation of which takes account of:		**260**		**388**	**(33)**
Surplus on disposal of fixed assets	109		-		100
Interest receivable	175		123		42
Interest payable	(1,150)		(728)		57
Tax payable (net of grant)	(13)		(-)		100
Other charges	(53)		(-)		100

Source: National Audit Office, using Housing Corporation data

Appendix 5

Improvements to the Corporation's financial ratios recommended by Standard & Poor's

Housing Corporation Ratio	To test whether an RSL ...	Calculation of existing ratio	Ratio proposed by Standard & Poor's	Commentary on the ratio and its use
Quick	could, if required, repay its current liabilities from its current assets	Liquid current assets divided by current liabilities	Same, but change the way it is applied	If an RSL fails this test, regulation staff carry out additional tests. If the RSL has loan or overdraft facilities in place, the Corporation grades it as satisfactory; if not, regulation staff add one month's rent to the current assets and recalculate the ratio. Standard & Poor's recommended that this latter practice be stopped as the entire rental income for the next month is unlikely to be available to meet liabilities.
Cash flow	is generating sufficient cash from its operations and investments to meet its operating costs and interest payments	(Net cash flow from operating activities plus interest received) divided by interest paid	Replace with Funds from Operations interest cover: (Net cash flow from operating activities plus or minus movement in working capital less net tax paid plus interest received) divided by interest paid	Standard & Poor's recommended that this ratio be broadened to test whether the cash flow from operating activities was sufficient to meet the RSL's full tax and interest obligations. The new ratio also reduces the scope for distortions to cash flow caused, for example, by an RSL delaying its payments to creditors.
Cash flow forecast	forecasts a net cash inflow or outflow over the next 12 months	Cash inflow less cash outflow	Delete	Standard & Poor's considered that this ratio was of limited use and should be discontinued.
Unqualified accounts	has been assessed as a going concern by its auditors	N/A	Same	Retain this check.
Interest cover	can meet its interest payments from its operating revenue	Operating surplus plus interest earned, less net tax payable) divided by interest payable	Replace with: (Operating surplus plus interest earned plus depreciation) divided by (interest payable plus capitalised interest)	Standard & Poor's recommended changes to this ratio to remove the distortion caused by differing approaches to dealing with tax, depreciation and capitalisation of interest.
Gearing	has the capacity to continue borrowing	Three gearing ratios in use: gearing rent; gearing reserves; and gearing market value (existing use) of properties	Same	Retain these ratios.
Increasing reserves	is increasing or reducing its accumulated surplus	Accumulated surplus at year end less accumulated surplus at start of year	Delete	Standard & Poor's considered that this ratio was of limited use and should be deleted.
Maintenance cover	has the capacity to fund major repairs	A complex ratio which was very difficult to understand and interpret	Replace with: Check that an independent major repairs survey has been undertaken in the past five years and whether planned major repairs expenditure is at least 75 per cent of that identified in the survey averaged over the next three years	Standard & Poor's recommended a new, two-stage test to show more clearly whether an RSL has identified and is making adequate provision for its repair responsibilities.
Rent losses	has problems with high levels of voids and bad debts	Rent losses from voids and bad debts divided by rent receivable	Same	Retain this ratio.
Rent arrears	has problems with rent arrears minus provision for bad debts	(Rent arrears less provision for bad debts) divided by rent receivable	Same	Retain this ratio.
ADDITIONAL RATIOS RECOMMENDED BY STANDARD & POOR'S:				
Budgetary performance	achieves its own business plan targets	None	Check that actual operating surplus and net cash in/out flow after debt service are at least 80 per cent of planned levels	The Corporation currently has no indicators or measures of the effectiveness of an RSL's budgetary performance.
Refinancing risk	is likely to face refinancing risks	None	Check that debt due to be repaid in next year divided by total outstanding debt does not exceed 25 per cent of total debt outstanding and that the gearing (reserves) ratio does not exceed 25 per cent	The Corporation currently has no ratio to measure the extent to which an RSL is reliant on short term funding, which might prove more time-consuming and costly to refinance than longer term funding.

Appendix 6 RSLs' responses to the NAO survey

Part A - Your views on the Corporation's regulation of RSLs' management of financial risk

This Part is intended to gauge RSLs' views on how efficiently and effectively the Corporation regulates RSLs' management of financial risk and on whether the Corporation could make further improvements in its regime of financial regulation.

QUESTION 1

To what extent do you agree or disagree with the following statements about the Corporation's performance standards that have a bearing on the governance and finance of your RSL(*)?

Please tick one box on each row.

The Corporation's standards which have a bearing on RSL governance and finance:

	Strongly agree	Agree	Disagree	Strongly disagree	Not stated
i. are easy to understand.	28	127	10	3	1
ii. are achievable.	10	141	17	0	1
iii. are all relevant to the management of financial risk in my organisation.	12	115	37	3	1
iv. cover all major aspects of financial risk management in my organisation.	7	130	26	3	3
v. help my organisation manage its financial risks.	8	123	34	3	1
vi. reflect best practice in the management of financial risk by RSLs.	7	124	29	1	8
vii. are updated regularly to take account of relevant changes in the sector.	1	112	51	2	3

* Note: for the purposes of our study, we have defined the performance standards that have a bearing on your organisation's governance and finance as:
the Governance and Finance Standards A, B and C; and
the Social Housing Standards D1.2 and D1.3, D3 and D4, E3, H1.1, I2.1 and I2.2(d) and I3.

If you disagree or strongly disagree with any of the statements in the above table, please explain why, with reference to specific performance standards.

QUESTION 2

To what extent do you agree or disagree with the following statements about the Corporation's regulation of RSLs' management of financial risk?

The Corporation:

	Strongly agree	Agree	Disagree	Strongly disagree	Not stated
i. collects all of the right information.	5	110	44	3	7
ii. has a good understanding of my organisation's business.	10	100	50	6	3
iii. has staff with the right skills regulating my organisation's management of financial risk.	8	96	52	6	7
iv. has staff with the necessary business experience regulating my organisation's management of financial risk.	1	63	83	12	10
v. has a regulatory regime that keeps my organisation's compliance costs reasonable.	5	101	48	9	6
vi. provides my organisation with appropriate feedback on the results of its reviews.	4	98	56	7	4
vii. reaches the right judgement about my organisation's financial position.	8	119	32	6	4
viii. reaches the right judgement about my organisation's governance and financial management.	8	130	24	2	5
ix. reaches the right judgement overall about my organisation's management of financial risks.	10	126	22	2	9
x. provides my organisation with timely feedback on the results of its reviews.	6	85	61	11	6
xi. takes appropriate action when problems emerge in my organisation.	6	97	30	5	31
xii. takes timely action when problems emerge in my organisation.	8	97	26	4	34
xiii. has helped my organisation improve its management of financial risk.	8	95	51	7	8
xiv. helps to reduce the cost of borrowing for my organisation.	13	65	62	11	18
xv. helps to reduce the cost of borrowing for the sector as a whole.	20	94	35	6	14
xvi. disseminates lessons learned to help improve the financial health of the sector.	4	107	45	5	8

If you disagree or strongly disagree with any of these statements, please explain why, with reference to the specific statements made.

QUESTION 3

In your view, how efficient and effective is the Corporation's regulation of RSLs' management of financial risk across the sector as a whole?

Please tick one box on each row.

Very efficient	6	Efficient	118	Inefficient	26	Very inefficient	1	Not stated	17
Highly effective	4	Effective	118	Ineffective	27	Highly ineffective	1	Not stated	16

Please provide a brief explanation for your answers:

Please feel free to provide any other comments that you might have about the Corporation's regulation, in particular, about how the Corporation might make its regulation of financial risk within RSLs more effective and/or more efficient.

Part B - The activities and organisation of your RSL

This Part is intended to ascertain the extent of diversification and re-organisation by your RSL, the impact on your RSL's financial risk and the action taken to manage that risk.

Extension or diversification into new business activities

We are aware of the proposals set out in the Housing Corporation's *Regulating Diversity* discussion paper and of the National Housing Federation's response. In this section, we are interested in finding out about business activities that are new to your RSL and are not concerned with definitions of core or non-core social housing activities.

QUESTION 4

In the past three years, has your RSL extended or diversified its business into activities that are new to your organisation?

Yes 82 **No** 83 **Not stated** 4

QUESTION 5

Over the next three years, does your RSL plan to move into new types of business activity that would represent a large part of its operations?

Yes 62 **No** 95 **Not stated** 12

If your answer to both questions is "no", please go directly to question 13.

If your answer to either question is "yes", please tick the relevant box(es) for the type(s) of activity concerned:

New business activities undertaken in the past three years	Type of business activity	New business activities planned over the next three years
15	Managed care services	13
13	Domiciliary services and day centres	9
7	Residential and nursing homes	14
5	Nurses' and other key worker accommodation	15
11	Management of local authority or other organisations' social housing stock	22
13	Short life housing association leasing schemes for the homeless, with or without grant funding	5
8	Student accommodation for universities and colleges	14
23	Youth, employment or other community-focused activities, for example Foyers	17
27	Community regeneration initiatives	26
23	Market renting	23
22	Other activities (please describe in the box below)	12

QUESTION 6

If your RSL has diversified in the past three years, or is planning to diversify over the next three years, please explain why:

Only answer questions 7 and 9 if your answer to question 4 was "yes".

Only answer questions 8 and 10 if your answer to question 5 was "yes".

QUESTION 7

How much gross income did your RSL generate from these new activities, and what percentage of total turnover did this represent, during the last full financial year?

Financial year	Gross income from new activities	Percentage of your RSL's total turnover
1998-99	£149 million	5.55

QUESTION 8

How much gross income does your RSL plan generate from these new activities, and what percentage of total turnover will this represent, over the next full financial year?

Financial year	Gross income from planned new activities	Percentage of your RSL's planned total turnover
1999-00	£63.9 million	6.64

QUESTION 9

Have any of the new business activities undertaken in the past three years involved your RSL creating physical assets or taking on financial liabilities?

Yes	56	No	26

If your answer to question 9 is "yes", please indicate how much money, in total, your RSL has invested in such assets, or has taken on in liabilities, from these activities in the past three years:

Total invested in assets for new business activities	Total liabilities taken on from newbusiness activities
£149.7 million	£67.9 million

QUESTION 10

Will any of the new business activities planned over the next three years involve your RSL creating physical assets or taking on financial liabilities?

Yes	61	No	-

If your answer to question 10 is "yes", please indicate how much money, in total, your RSL plans to invest in such assets, or take on in liabilities, from these activities over the next three years:

Total planned investment in assets for new business activities	Total liabilities planned to be taken on from new business activities
£261.8 million	£115.2 million

QUESTION 11

In your view, what is the impact or likely impact on your RSL's financial risks of the new business activities undertaken in the past three years or planned over the next three years?

Please tick one box.

A big increase in financial risk	Increased financial risk	No change in financial risk	Reduced financial risk	A big reduction in financial risk
2	37	54	12	1

Note: for the purposes of our study, we are concerned about material financial risks that would have a probable and significant financial impact on an RSL's financial position.

QUESTION 12

What specific action has your RSL taken to ensure that it has been able to manage properly the financial risks associated with the new business activities that it has undertaken in the past three years?

If your RSL has taken no specific action, please explain why.

Changes in the structural arrangements for the delivery of services

In this section, we are interested in changes that result in the establishment of additional business units or relationships with other RSLs. We are not concerned about internal re-organisation of posts or responsibilities.

QUESTION 13

In the past three years, has your RSL changed its corporate structure, or entered into structural partnerships, in any significant way?

Yes	48	**No**	110	**Not stated**	11

QUESTION 14

Over the next three years, does your RSL have plans to change its corporate structure in any significant way?

Yes	51	**No**	106	**Not stated**	12

If your answer to both questions is "no", please go directly to the free text box on page 13.

If your answer to either question is "yes", please tick the box(es) for the type(s) of structural change(s):

Structural change(s) made in the past three years	Type of structural change	Structural change(s) planned over the next three years
5	Creation of a group structure with all subsidiaries registered by the Corporation	12
17	Creation of a group structure including unregistered subsidiaries	14
7	Creation of new registered subsidiaries in an existing group structure	9
6	Creation of new unregistered subsidiaries in an existing group structure	12
5	Merger with another RSL through a transfer of engagements	4
1	Amalgamation with another RSL to form a new RSL	1
4	Formal legal partnership, such as a joint venture, with another RSL	12
15	Other structural changes (please describe below)	11

QUESTION 15

In your view, what is the impact or likely impact on your RSL's financial risks of the changes in corporate structure that your organisation has made in the past three years or plans to make over the next three years?

Please tick one box.

A big increase in financial risk		Increased financial risk		No change in financial risk		Reduced financial risk		A big reduction in financial risk	
	0		13		38		31		5

Note: for the purposes of our study, we are concerned about material financial risks that would have a probable and significant financial impact on an RSL's financial position.

QUESTION 16

What specific action has your RSL taken to ensure that it has been able to manage properly the financial risks associated with the changes in its corporate structure in the past three years?

If your RSL has taken no specific action, please explain why.

Please feel free to provide any other comments that you might have about your organisation's extension or diversification into new business activities or changes in its corporate structure, in particular, about the financial risks associated with these developments and how the Housing Corporation's financial regulation should respond.