Practical Guidance on Governance and Financial Management

Briefing 1 - Effective financial management

SHARE
TRAINING FOR HOUSING ASSOCIATIONS

GWSF
Glasgow and West of Scotland Forum of Housing Associations

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This guide, jointly produced by GWSF and SHARE, is the first in a short series of briefings designed to give a brief overview of some of the key governance and financial management considerations which should be applied by any RSL and, in particular, by its management committee with overall responsibility for the organisation. It is clearly up to each RSL to determine how it should operate to meet the standards: this guidance should not be taken as the only approach but primarily as a discussion guide to test how the RSL is managing this area effectively. It is aimed mainly at management committee members.

[Please note we use the term 'management committee' to also refer to 'board'.]

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1 Introduction – where finance fits into the overall governance standards

Good governance is crucial to the wellbeing and stability of an RSL. It is achieved by effective leadership of the organisation by the management committee and senior staff through the development of robust and clear policies and procedures which meet legislative and regulatory standards.

It has been well documented there are some aspects of governance within a small but growing number of RSLs which have created challenges within the sector. The Scottish Housing Regulator says that governance issues now account for 23% of the RSLs they engage with - this has increased markedly from 2015/16.

Principal reasons RSL engagement

	2015/16 (%)	2016/17 (%)
Financial Health	67	65
Governance	15	23
Service Quality	7	8
Stock Quality	11	4

Scottish Housing Regulator Annual Performance Report & Accounts 2016/17

The Regulatory Standards of Governance and Financial Management set out six standards which all RSLs should adhere to. They are generally cross-cutting and relate to all aspects of good governance, and although this briefing will not explore the standards in any detail it will use these as the guiding principles for the practical advice provided:

The governing body leads and directs the RSL to achieve good outcomes for its tenants and other service users.

The RSL is open about and accountable for what it does. It understands and takes account of the needs and priorities of its tenants, service users and stakeholders. And its primary focus is the sustainable achievement of these priorities.

The RSL manages its resources to ensure its financial well-being and economic effectiveness.

The governing body bases its decisions on good quality information and advice and identifies and mitigates risks to the organisation's purpose.

The RSL conducts its affairs with honesty and integrity.

The governing body and senior officers have the skills and knowledge they need to be effective.

A lot of the information provided on governance is about high level standards and principles, but there is less in the way of practical guidance for management committee members. This briefing focuses on financial management as one particular area of governance, and aims to provide a range of practical guidance, tips and tools to support committee members in managing their RSL.

2 The management committee's roles and responsibilities on financial management

Broadly speaking, the management committee is responsible for the overall decision making of the RSL. They have ultimate responsibility for directing the activity of the organisation, ensuring it is well run and delivering the outcomes for which it has been set up.

In terms of financial management this is generally the oversight and approval of financial information, along with decisions relating to overall income and expenditure, and ensuring compliance with the financial policies and procedures of the organisation.

In general terms the responsibilities of the management committee in relation to financial management involve:

- Setting the strategic direction of the RSL
- Developing and approving appropriate financial policies and procedures which clearly set out the processes used and how they will be monitored
- Establishing mechanisms to control and monitor performance (e.g. the structure and frequency of committees and any sub-committees, how reports are written and presented, how recommendations are framed and agreed)
- Instructing a system of internal and external audit and reviewing recommendations and findings from these processes
- Having a clear understanding of the financial risks facing your organisation.

As an individual committee member your role is:

- To understand the financial information being provided and gaining the requisite knowledge to contribute to discussions. It's not appropriate to say you didn't challenge something because you didn't understand it!
- To ask questions when you don't understand – if you have a question then most likely one of your colleagues is thinking the same thing. In most cases the staff really welcome questions as they've spent considerable time producing the information and are very happy to discuss the detail.
- To ask for more information if you need it to perform your role – you're accountable so if you want more detail, want it in a different format or want to change how often you get it, then this should be communicated to those presenting the information
- To make decisions based on facts and evidence, taking account of the organisation's policies, procedures and business plan.
- To ignore trivial details and learn to recognise what's significant and what isn't. Having a budget item for £100 which is overspent by 100% (£200) is much less relevant than a budget of £100,000 overspent by 20% (£20,000) – pay attention to the scale of the numbers and ask why.

3 Understanding the financial risks

The management committee and senior staff must be aware of the external and internal financial risks facing the organisation. For each organisation these may be slightly different, or present a larger issue for some than for others. There should be regular discussion at both committee and management team level (and more generally across the whole organisation) on the risks to the RSL and how these can be managed.

Some typical risks needing to be considered include:

External Financial Risks		
Increasing construction costs	Legislative changes	Demographic change
Political changes, for example Brexit, new Government etc.	Interest rates / inflation	Accessing loan finance
Welfare reform, particularly Universal Credit	Increasing private rented sector	Other RSLs as competitors
Pensions deficit	Fuel poverty	Economic changes

Internal Financial Risks		
Rent arrears	Rent affordability	Poor governance
Procurement	Lack of skilled staff and committee / no succession plans	Increasing voids / empty homes
Size and complexity of an RSL	Inadequate reporting systems	Development programmes
Too much control for individuals	Out of date or inadequate policies and procedures	IT systems failures

This list is not exhaustive, and what is crucial is not just the identification of risk but how this will be managed.

RSLs should have a clear risk management strategy and risk assessment procedure which is monitored at a frequency which suits the complexity of the organisation, for example six monthly with a more detailed annual review. In general terms this should contain the following categories of information:

- A description of the main risks facing the RSL
- The impact should this event actually occur
- The probability of its occurrence
- A summary of the planned response should the event occur
- A summary of risk mitigation (the actions that can be taken in advance to reduce the probability and/or impact of the event).

4 Key financial documents

There are a range of internal documents which are used to manage the finances of an RSL. Some of these are produced internally and some through external bodies. In some instances these are produced and submitted to the Scottish Housing Regulator, but their core purpose is to be used as an internal reporting and monitoring tool. These include:

Business plan

The business plan is the overarching document which sets out the future plans and direction of the organisation. The strategic and business objectives produced within this plan outline what the RSL intends to deliver over a specified time period, usually 3-5 years. These should have been costed, reviewed and tested within any financial information presented to the management committee during this period.

Annual budget

The annual budget is the most accurate estimate of the income and expenditure which will occur during the year, and is usually presented around December prior to being implemented the following April. This document is then used by the RSL to monitor actual income and expenditure over the course of the year.

Management accounts

Management accounts are the tool used to monitor the annual budget and are produced to reflect a specified time frame, usually quarterly. These are reported to the management committee and discussed, identifying any variances and whether any changes need to be made to the assumptions used in the annual budget.

Five year annual projections

Although these are required to be submitted to the Scottish Housing Regulator, their core purpose is to provide the management committee with an estimate of future income and expenditure over a longer timeframe.

This should take account of all objectives within the business plan, potential risks and how these are factored in (for example Universal Credit) and provide comfort that the RSL will have sufficient cashflow to remain operational over this period.

Thirty year cashflow

While the information in this should be taken with caution, as it is impossible to determine income and expenditure and what will change internally and externally over a thirty year period, thirty year cashflows are generally produced annually, to demonstrate the ability of the RSL to give assurance on the financial viability over the longer term. The cashflow will take into account key areas like the possible rental income, the anticipated expenditure for maintaining and improving the homes (life cycle costs), and other areas like loan repayments, assumed staff costs etc.

[One way of thinking about this is that an annual budget should be reasonably accurate, five year projections are more of an educated guess with some limitations on their accuracy, and thirty year projections are very much a best guess at a point in time. The only sure thing is that things will change markedly over a thirty year period.]

Annual accounts

Annually the RSL is audited by an external auditor who will review the financial information over the year. This is done by testing various areas, and assures members and others that financial management is being carried out honestly and effectively.

Auditors are obliged to report any weaknesses in internal controls to the management committee and provide a management letter outlining their observations and recommendations. Any material/significant weaknesses will be contained within the publicly available annual accounts.

While the role of an external auditor provides some comfort for the management committee about how the RSL is operating, it should be remembered that auditors can't review all financial information and that the overall responsibility remains with the committee and the internal processes and monitoring it adopts.

Financial procedures

The internal financial procedures outline how the RSL will carry out its activities. This is the day to day guide to how financial management takes place within the organisation, from the managing of rental income to the expenditure limits for each staff member. This is the key internal control document for ensuring that the day to day governance of financial activities is effective.

A programme of internal audit should be considered, which is designed around examining and reviewing whether the RSL is following its policies and procedures in this (and other) relevant areas.

Scheme of financial delegation

The Scheme of Delegation is the financial framework which details the expenditure authorisation limits for the staff and committee. This ensures that release of expenditure is approved at an appropriate level within the organisation, and provides a mechanism for controlling the ability of individuals to act outwith their remit.

Payments and benefits

The purpose of this policy is to provide a framework which is explicit on what is acceptable in terms of entitlements, benefits and payments.

Put simply, this policy outlines what is appropriate for management committee and staff members (and those connected closely to them) to receive in terms of payments and benefits. It provides clarity on what would be deemed unsuitable or potentially dubious.

A register of interests administered by an appropriate staff member records particular payments and benefits where these are permitted, and this will be provided to the management committee for review and approval annually, or more frequently if required.

There are a range of other policies and procedures which have significant importance in terms of financial management, including the Treasury Management Policy, Procurement Policy and Asset Management Strategy. It's crucial that regular policy reviews are undertaken, and where changes are being proposed, the policies are tested and challenged through internal audit, peer benchmarking or regular training.

5 Understanding the terminology

A challenge for any management committee (and non-specialist senior staff) is understanding the financial terminology used when reports are being produced. In most cases the Finance Manager will explain these, but it's important that there is a basic level of understanding from those tasked with managing the RSL.

While there is a lot of different terminology used, some of the more frequent terms include:

- **Accruals** - *An expense incurred but not yet paid and, therefore, not yet in the accounts, for example if you install a kitchen in March costing £3,000 and the invoice isn't received by the end of the financial year this cost is accrued into the accounts to present a more accurate set of accounts*
- **Amortisation** - *The grant which was used to purchase a fixed asset, for example Housing Association Grant for new build homes, is then released bit by bit, year by year, as an income into the income and expenditure account*
- **Bad debts** - *Money owing by a customer which you are unlikely to recover*
- **Cash** - *This is generally the term used for the cumulative total of the different bank balances and savings the RSL has – this is displayed in the Statement of Financial Position and fundamentally provides the figure of the available cash which the RSL has*
- **Covenants** - *These are the agreements with lenders (usually banks) on the levels of surplus and borrowing the RSL should be achieving*
- **Current assets** - *Assets intended for use generally within that particular year. Current assets are mainly the money the RSL has in the bank or on interest- gaining deposits and money owed to them, most notably rent arrears less any assumptions for what is likely not to be recovered (bad debts)*
- **Current liabilities** - *Liabilities which must be discharged, generally within that particular year. Current liabilities general consist of the money the RSL owes out in the twelve month period, for example payments due to creditors (contractors etc.) and loan repayments*
- **Depreciation** - *The cost where a fixed asset is being released bit by bit, year by year, as an expense into the income and expenditure account*
- **Fixed assets** - *Assets which are a capital investment which retain some value over the term of their life, generally at least over five years*
- **Going concern** - *Forewarns of any threats to the continuing operation of an organisation*
- **Scenario planning** - *this is where the RSL will consider the potential issues which could affect income and expenditure, for example Universal Credit may have significant impact on rental income; increasing interest rates may have an impact on loan finance; Brexit may mean a lack of skilled construction workers which increases prices to maintain and improve homes. Each of these scenarios and more are considered and assumptions made on their impact on the RSL's future cashflows, which helps inform future decisions*
- *A* **surplus** *is an excess of income over expenditure, whilst a* **deficit** *is an excess of expenditure over income. These are displayed within the Statement of Comprehensive Income and it should be remembered that these do not necessarily mean an increase or decrease of the cash of the RSL*
- **Variance** - *The difference between the estimated figure in the budget and the actual figure (either positive + or negative -)*
- **Working capital** - *The difference (+ or -) between the current assets and current liabilities.*

6 Ten questions to ask!

1. How effectively are we recovering our rent? Without rental income there is no business, so how much focus is placed on this by the RSL?

2. Where there are **significant** variances in income or expenditure, what has caused this? In reviewing financial information presented to you, if the RSL has received more income or spent more money than had been anticipated, your role is to ask why!

3. What are the future events on the horizon which will affect our financial position? Be fully aware of what's happening in the world outside, what are the internal and external risks and opportunities and how does the RSL manage these?

4. Where could we make efficiencies and achieve better value for money? Your role is to manage the organisation and deliver value for money for the tenants and residents. There should be regular questions on whether things could be done differently, cheaper or better, and what would be the impact on providing the best service to the tenants.

5. What is the 'opportunity cost' of one particular approach? If we are choosing to invest or spend money in one area, such as development, a new IT system, new staff etc., what are the gains and advantages to the existing customers and organisation as a whole? Always consider whether this expenditure could be put to better use in another area of your work.

6. How does this fit with our business plan? Have a clear understanding of the organisation's business plan and what it hopes to achieve, and make sure you're happy that any financial information is consistent with the business plan agreed by the management committee at the outset.

7. What costs are 'fixed' and what are 'variable'? Understand what costs don't change dramatically (for example office rental, staff costs etc.) and what costs can change significantly (repairs costs etc.), as the variable costs will be the ones where you have greater ability to make decisions on how activities are delivered.

8. Are we making the right assumptions? Compare and contrast with other RSLs the assumptions made on future repairs costs, inflation, loan costs and rent increases. Be aware that these will have a significant bearing on your future income and expenditure. Sometimes you might be able to make these comparisons by talking with committee colleagues from other RSLs, but if not, ask if staff can provide the information.

9. What control do we have over the budgeting process? How is the budget developed? What role do the management committee wish in the process - is agreeing the business plan enough or are more detailed discussions needed? Determine what's appropriate for your organisation.

10. Be inquisitive! Asking questions increases your own and your colleagues' knowledge. Speak to colleagues about what courses are available or ask for time with the manager to discuss the reports (they will appreciate the opportunity to explain their work to you).

7 Some good practice ideas

On reviewing some of the governance challenges which have been experienced by RSLs over the last few years, common themes emerge. These include a lack of challenge from the management committee and senior staff teams, a lack of understanding of what was and wasn't permitted, and a failure to apply simple mechanisms to limit the opportunities for failures or mismanagement.

Some of the examples below may be used to help implement procedures which, while not eradicating the ability for failures in financial management to occur, may assist in early identification of problems and limit the scope for these to become bigger issues:

- **Use of corporate credit cards**: Clear policy on the use of these cards and how they will be authorised, for example no one person should be able to spend and authorise for themselves
- **Employment terms**: Undertake a regular review to ensure compliance with the contracts of employment and terms and conditions in terms of expenses, overtime, pensions and salary payments. This should also include a review of senior staff remuneration to ensure it is within the terms of the employment contract and regulatory guidance
- **Ensure declarations** of all additional items provided to staff in terms of their employment are included within the accounts and contracts of employment
- **Settlement agreements**: these and any other financial payments outwith the terms of the employee contract must be discussed and formally approved by committee
- **Loan agreements**: annual review of compliance with these and clearer understanding for committee on the terms by which the RSL is bound
- **Payments to third parties** (e.g. contractors and suppliers): ensuring contracts are in place and appropriate tender methods have been used
- **Having a clear and explicit delegation of expenditure** which has been approved and authorised by the management committee, while not mandatory, represents good practice and clarity for those with responsibility for approving expenditure
- **Consider the benefits of having an audit and risk sub-committee** with a clear remit which may include an internal audit programme, risk management, management accounts, and financial returns. In all cases this would allow for further discussion at the sub-committee, but should be accessible to the full committee for noting and comment
- **External verification** as a matter of course – at least on a three yearly basis have a consultant review compliance with loan agreements, budget process, five year financial projections and 30 year cashflow

- **Clear policy on how the RSL tests financial management** which is documented to outline the remit in terms of management team meetings, committee and sub-committee meetings, internal audit programme and external verification

- **An annual training programme** incorporating appropriate training on financial management, using both internal and external specialists, which is designed for both management committee and senior staff

- **Consider an independent review of reporting systems** through a critical evaluation of the reports provided to management committee. This can be done through peer group support, external consultants or through the use of a 'critical friend'

- **Encourage a culture** where senior staff challenge each other constructively. Financial challenge and understanding has to be throughout the organisation, and the role of the management team is to discuss, negotiate and challenge each other for the best interests of the RSL

- **Management team meetings** should review management accounts, joined up budget setting and involvement/ decision in areas of financial management

- **Significant monetary decisions** such as on new development, large scale procurement, staff restructure, new IT systems etc., should be subject to a full risk assessment and are also likely to benefit from appropriate external advice.

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GWSF's purpose is to promote and represent local community controlled housing associations and co-operatives in Glasgow and the west of Scotland

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SHARE provides learning and development support to the housing sector ensuring staff and Committee/ Board members have the knowledge and skills to deliver high quality services and maintain financially sound, well-governed organisations able to tackle current and future challenges.