

RSL

TECHNICAL UPDATE

SUMMER 2009

ALEXANDER SLOAN CHARTERED ACCOUNTANTS

HOW ARE YOU 'SHAPING UP' FOR THE FUTURE?

"THE WEAKNESSES WE FOUND IN BUSINESS PLANNING, IN TERMS OF ARTICULATING KEY RISKS, INTEGRATING INVESTMENT DECISIONS AND FINANCIAL FORECASTS INTO BUSINESS PLANNING AND THE LACK OF SENSITIVITY ANALYSIS MEANS THAT THERE IS AN URGENT NEED FOR IMPROVEMENT ACROSS THE SECTOR" - SHR – SHAPING UP FOR IMPROVEMENT (JULY 2009)

Over the last few years whichever body had the role of regulating RSLs in Scotland has adopted a fairly light touch approach to the finance function. The regulator has in the past focused on service outcomes and the finance function was not graded when performance audits were carried out.

Recently however the focus has changed and reading a selection of the Regulation Plans for 2009 shows that regulatory attention is very much on business planning and in particular financial planning. The Scottish Housing Regulator's recent publication "Shaping Up for Improvement" also highlighted the increase in focus on financial viability and also underlined the regulator's unease at the quality of business planning in the sector.

In the course of our work we often review the business plans and financial projections of clients. We therefore feel, in light of the regulator's focus on the topic, that it would be useful to highlight some of the financial planning issues that we come across and also provide some guidance on preparing and updating financial plans.

Examples of financial planning issues that we come across include:

Financial Plans ≠ Business Plans

Financial projections are often carried out as a separate exercise from the overall business plan. As a result the financial resources required to meet the objectives and targets outlined in the business plan are not accounted for. Or, more commonly, the financial plans conflict with strategic objectives or the RSL's overall mission. For example, the RSL has a strategic objective of providing low cost affordable housing, but has financial plans that predict continuous above inflation rent rises and £50m in the bank at the end of the period.

Not using plans to their full potential

Long-term and Medium-term financial projections are often seen as a burdensome regulatory requirement. The benefits of having a functioning financial model are sometimes overlooked. We often find that no sensitivity analysis or scenario planning is carried out and the forecasts are an end in themselves, rather than a useful management tool which can be used to understand the business.

Assumptions v the real world

It is not easy to produce a realistic suite of financial assumptions with which to develop a financial model, particularly as past experience is often a poor indicator of future performance. It is important to step back from assumptions made and consider how realistic they are and also try and identify the inter-dependences between financial variables.

How are you 'Shaping Up' for the future

Future-proofing

Many financial plans are prepared using a series of inter-connected spreadsheets which are necessarily complex. It is easy for these spreadsheets to, over time, become messy and inflexible. It is therefore essential when designing the model that 'room to grow' is designed into the model and that data fields are broken down as far as possible to allow for greater flexibility in the future.

Quality Control and lack of challenge

More often than not financial planning work is undertaken by the most senior member of the finance staff. Quite often this member of staff is the only person with the necessary skills and experience to perform this work. This creates the problem that there is then no one available to review the work done. Financial plans are normally very complex and it would be unusual for them to have been prepared without any flaw in their design or for all assumptions made to be incapable of being challenged.

Guidance

As well as articulating the RSL's long-term plans in financial terms, well designed financial forecasts are an essential management tool that can be used by the RSL to gain a better understanding of its business. In order to get the best out of financial forecasts the following should be considered:

Sensitivity Analysis and Stress Testing

The lack of Sensitivity Analysis and Stress Testing within financial projections has been highlighted as a weakness within the sector. It is easy when carrying out sensitivity work to stick to obvious financial variables, such as inflation, and look at a spread of a few percentage points and stop there. However, by linking further sensitivity analyses to the RSL's Risk Register, more realistic and useful scenarios can be produced and examined.

Design

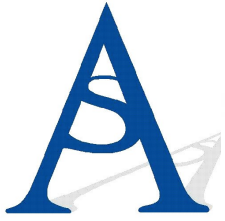
The more sophisticated the financial model the more useful it will be in examining scenarios. If sweeping broad assumptions are used then the model is unlikely to be particularly useful when considering sensitivity analysis and scenarios. However, the downside of a complex model is that the more sophisticated it is the more expensive in terms of staff time it is to produce. There is therefore a balance to be struck in the degree of sophistication. The principal driver of this balance should be the level of financial risk.

Clarity

It is highlighted in the Regulator's recent publication that often only a finance officer or external adviser fully understands an RSL's financial forecasts and the financial risks that it undertakes. Financial plans are often intimidating for people who are not from a finance background and more often than not are presented as a mass of figures and any interpretation of the data is left to the reader. It is therefore important to seek to present this information in a more accessible format. One simple way of doing this would be to present summary information in a graphical form and provide commentary to supply the analysis of the information.

Alexander Sloan are planning to host an RSL Seminar in early December where a number of issues will be covered including financial planning and risk management. However, if you have any queries with regard to any of the issues raised in this article or require assistance with financial plans please feel free to contact us, using the email address below. *Phil Morrice*

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Other RSL News

Name Change for Industrial & Provident Societies

Legislative Reform Order

The substantial majority of RSLs are Industrial and Provident Societies. The legislation dealing with these types of entity dates back mostly to the 1950s and 1960s. The government has recently consulted on and published a draft Legislative Reform Order regarding credit unions and industrial and provident societies. The draft order will make some minor changes to the law governing industrial and provident societies.

However as a result of the issues raised during the consultation, a Private Member's Bill that has government support has been introduced.

The government has stated that it aims to bring the legislative framework of Industrial & Provident Societies up to date. So it is likely that in future further changes will be implemented.

Private Member's Bill

The Bill which is currently before the House of Lords makes the following recommendations that will have an impact on those RSLs that are Industrial and Provident Societies:

Industrial and Provident Societies are to be renamed 'Co-operative Societies' or 'Community Benefit Societies' and legislation relating to them will be renamed accordingly.

The Company Directors Disqualification Act 1986 will apply to the officers of Industrial and Provident Societies as it does currently to Companies

We will provide further updates on new legislation in future issues of our newsletter.

RSL Seminar

Alexander Sloan are planning to host an RSL Seminar in early December 2009. It is proposed that the seminar will cover the following topics:

- Financial Planning
- Risk Management
- Auditing and Accounting Issues
- RSL Accounts Template – Version 2.0

Full details of the seminar will be available at the Alexander Sloan stand at the forthcoming SFHA Finance Conference in Crieff and on the Alexander Sloan Website.

RSL Accounts Template

As we stated in our previous newsletter we introduced a new Excel-driven accounts template this year. We hope that those of you that used it felt that it improved the accounts preparation process, both in terms of efficiency and the presentation of the financial statements.

We will seek to make improvements to the template every year so that the benefits to both ourselves and those RSLs that use the template increase. Therefore we would welcome any feedback from people that used the template so that we can make improvements to the 2010 version.

We will also be discussing proposed changes to the template at the forthcoming seminar. However, if you wish to provide us with feedback please email us at rsl@alexandersloan.co.uk



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ABOUT ALEXANDER SLOAN

We are one of the largest auditors of registered Social Landlords. Housing Associations are a key part of our business and we therefore devote significant resources to ensure we are kept up to date with the latest developments in RSLs. As part of this strategy all of our audit staff receive regular training on the latest developments in RSLs.

From our offices in Glasgow and Edinburgh we provide a range of services for housing associations including:-

External Audit

Internal Audit

Financial Planning

Training for Board and Committee Members and Staff

Financial Projections

Appraisal of lending packages



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