

## Briefing Paper

# Proposed Capital Finance Arrangements under the New Housing Finance System

March 2011

## 1. Introduction

- 1.1 Communities & Local Government published a paper: 'Implementing Self-Financing for Council Housing' on 1<sup>st</sup> February 2011. This paper contains the coalition government's detailed proposals for the introduction of self-financing to the Housing Revenue Account and follows papers issued by the former Labour government. Briefing papers on these papers are available on the 'AWICS' website:
- Housing Revenue Account Review – July 2009
  - Reform of Council Housing Finance – July 2009
  - Council Housing: A Real Future – April 2010
  - Council Housing: A Real Future – AWICS response – July 2010
  - Implementing Self-Financing for Council Housing – February 2011
- 1.2 At the same time the Chartered Institute of Public Finance & Accountancy published a 'Consultation on Proposed Capital Finance Arrangements under the New Housing Finance system'. This consultation paper relates to the proposals for the management of debt and depreciation under the new arrangements.
- 1.3 The purpose of this briefing paper is to summarise the proposals on the proposed capital finance arrangements under the new housing finance system that are being made by the Chartered Institute of Public Finance & Accountancy and to comment on them.
- 1.4 'AWICS' has responded to the consultation paper and the response of 'AWICS' is also included in this briefing paper as an appendix.

## 2. Management of Debt

### 2.1 Introduction

- 2.1.1 On management of debt the paper proposes that local authorities operate two loans pools in future – one for the General Fund and one for the Housing Revenue Account. It outlines how opening debt should be divided between these two pools before self-financing is introduced.

## 2.2 Proposals

- 2.2.1 Self-financing will result in significant adjustments to the level of housing debt in authorities with council housing. In most cases the level of debt will increase significantly. Authorities will also have to change the way in which they manage and account for their debt so that the housing and non-housing debt can be dealt with separately thus avoiding decisions on housing debt having an impact on capital financing costs in the general fund and vice versa.
- 2.2.2 The Chartered Institute of Public Finance & Accountancy has therefore worked with government to identify a methodology for splitting debt to meet the requirements of the new system. The government has signalled its intention not to impose a single solution and authorities may pursue other methods provided that they achieve the underlying principles.
- 2.2.3 Three principles have been identified:
- Debt must be managed equitably for the Housing Revenue Account and General Fund.
  - Future charges to the Housing Revenue Account for borrowing will not be influenced by General Fund decisions.
  - Un-invested balance sheet resources to be properly identified between the General Fund and Housing Revenue Account.
- 2.2.4 It is anticipated that only long-term loans will be split. Revenue balances and short-term loans for cash purposes will continue to be managed as part of an authority's overall cash balances with interest being charged or credited as part of the calculation of interest on cash balances.
- 2.2.5 The proposed solution is:

Where sufficient loans exist, the loans taken on by the Housing Revenue Account are calculated as follows:

Housing share of Public Works Loans Board debt:  $\text{Public Works Loans Board (Housing debt)} = \frac{\text{Housing Revenue Account Capital Financing Requirement}}{\text{Total loans}} \times \text{Public Works Loans Board loans}$

Housing share of market loans:  $\text{ML (H)} = \frac{\text{Housing Revenue Account Capital Financing Requirement}}{\text{Total loans}} \times \text{Market loans}$

Where insufficient loans exist (Housing Revenue Account Capital Financing Requirement > Total Loans), the balance is represented by unfinanced Capital Financing Requirement.

NB: Housing Revenue Account Capital Financing Requirement = Housing Revenue Account Capital Financing Requirement: The Housing Revenue Account share of the authority's total Capital Financing Requirement.

This is illustrated in the example below:

Capital Financing Requirement			
Split	£,000	Existing Debt	£,000
Housing Revenue Account	20,000	Public Works Loans Board	28,000
General Fund	24,000	Market Loans	12,000
		Unfinanced	4,000
Total	44,000	Total	44,000
Housing share 50% of loans			
		Public Works Loans Board	14,000
		Market Loans	6,000
		Total	20,000

- 2.2.6 Where the Housing Revenue Account takes on unfinanced Capital Financing Requirement the choice is to take on additional borrowing or to pay interest to the General Fund to cover the unfinanced capital financing requirement. All types of loan should be split between the Housing Revenue Account and the General Fund. It is considered that it should be possible to split all Public Works Loans Board debt although it may not be necessary to do this physically on day one. Only market loans taken on as long-term loans should be shared with the Housing Revenue Account. Where authorities can achieve the same impact by allocation of complete individual loans between the Housing Revenue Account and General Fund this should be done.
- 2.2.7 Where authorities make a payment to the government at the settlement date there will be a corresponding increase in the Housing Capital Financing Requirement. The authority can then take out additional borrowing up to this level. The cash for the payment to the government would come from the loan.
- 2.2.8 Where authorities receive a settlement from the government, there is a requirement that they repay Public Works Loans Board debt. To ensure that debt can be repaid to the Public Works Loans Board there would be a need to repay the Public Works Loans Board loans before splitting the residual loans between the Housing Revenue Account and the General Fund. The repayment would reduce the Housing Revenue Account Capital Financing Requirement and hence the amount to be apportioned to the Housing Revenue Account.

- 2.2.9 Where an authority is debt free it currently does not need to make a Minimum Revenue Provision (make repayments of debt) in the General Fund. This can arise where an authority has debt in the General Fund but not in the Housing Revenue Account. In such a case an increase in Housing Revenue Account debt could result in a need to make a Minimum Revenue Provision in the General Fund. Communities & Local Government are giving consideration as to how this issue may be addressed. 'AWICS' has suggested in its submission to the Chartered Institute of Public Finance & Accountancy that this could be resolved by making it a matter for local discretion to determine whether or not to make a Minimum Revenue Provision in the General Fund in the same way as is already the case in the Housing Revenue Account. This would appear to be consistent with the principles of Localism.
- 2.2.10 It is important to note that where a council has a negative Subsidy Capital Financing Requirement (the subsidy system assumes that the Council has a negative amount of debt in the Housing Revenue Account), Communities & Local Government has set the Subsidy Capital Financing Requirement at nil for purposes of calculating the self-financing settlement. In these cases the additional debt that Councils will be expected to accept will be less than the difference between the Subsidy Capital Financing Requirement and the tenanted market valuation for self-financing purposes.
- 2.2.11 The Chartered Institute of Public Finance & Accountancy also considered a one-pool or a three-pool approach. With a one pool approach the current arrangements would continue. With a three pool approach there would be a pool for existing debt and two new pools for new Housing Revenue Account and General Fund debt. It is suggested that local authorities could opt for either of these options if they considered that specific advantages could be identified at local level.
- 2.2.12 The paper notes with regard to a single pool that:
- “It may initially seem attractive to local authorities to continue with a single pool...Administratively it definitely has advantages (but)... most authorities will have materially different debt levels as a result of the settlement... This change in debt is likely to have a significant impact on the apportionment of interest... Maintaining a single pool approach will restrict the authority’s ability to manage interest rates according to the Housing Revenue Account’s debt and risk profile.”*
- 2.2.13 The paper notes with regard to three pools that:
- “Because of the difficulties around debt repayment and interest rate management the two pool approach would appear to be preferable in the long-run.”*
- 2.2.14 The consultation paper asks three specific questions about management of debt:
- Comments are requested on whether Treasury Management systems will be able to manage two portfolios.

- There may be authorities whose debt reduction exceeds their Public Works Loans Board borrowing, resulting in early settlement premiums becoming payable on market loans. We are seeking to establish how widespread this is and whether these authorities would seek to repay debt and what the potential costs might be.
- Debt free authorities may become liable to MRP, again we are seeking to establish how widespread this is and what the cost implications might be.

## **2.3 Conclusions**

- 2.3.1 The proposals contained in the consultation paper on management of debt appear to represent the most practical way forward in the current circumstances. They also allow authorities to adopt an alternative approach if they consider that this would be best in view of the local circumstances.
- 2.3.2 There is the issue of the treatment of Minimum Revenue Provision in the General Fund in currently debt-free authorities. My preferred solution to this matter would be for the making of Minimum Revenue Provision in the General Fund discretionary in the same way as it already is in the Housing Revenue Account.

## **3. Depreciation**

### **3.1 Introduction**

- 3.1.1 On depreciation the paper puts forward a proposal for calculating depreciation based on depreciating different building components separately in accordance with International Financial Reporting Standards. The treatment of depreciation is important as the major repairs allowance will be abolished with self-financing and it is proposed that the depreciation charge will become the sum that is transferred to the major repairs reserve to fund major repairs. Depreciation will therefore become a real cost in the housing revenue account on the basis of these proposals.

### **3.2 Concerns about Depreciation and Self-Financing**

- 3.2.1 Concerns have been expressed about depreciation and self-financing, not least by 'AWICS'.
- 3.2.2 At present, charges for depreciation and impairment are made to the Housing Revenue Account. However, in practice these are notional charges as they are 'reversed out' of the account and the charge that is actually made to the account is the transfer of the Major Repairs Allowance to the Major Repairs Reserve. Usually, depreciation is greater than the Major Repairs Allowance and if impairment is charged this is totally 'reversed out'.
- 3.2.3 The introduction of self-financing means that there will no longer be an annual calculation of the Major Repairs Allowance. Resources for major repairs will, in theory, be built into the calculation of tenanted market value and there should therefore be sufficient resources in the rent stream to fund major repairs at the level that has been assumed in the self-financing settlement.

- 3.2.4 There is therefore a need to decide how Councils will determine how much to transfer into the Major Repairs Reserve. The amount needs to be sufficient to meet the cost of ongoing major repairs and also needs to be affordable. The proposal is that this should be achieved by using depreciation – with depreciation no longer being ‘reversed out’ and becoming a real charge to the Housing Revenue Account.
- 3.2.5 Advocates of this approach argue that depreciation is a good measure of the need to set resources aside for major repairs. For example, if new kitchens on an estate cost £300,000 and are estimated to last thirty years, depreciation of £10,000 a year should be sufficient to create a reserve to replace the kitchens when this is due. However, this approach is seen as having two disadvantages: First, it is argued that this is not logical given that Council housing is valued on the basis of Existing Use Value for Social Housing rather than at Market Value (see below) and Second, that depreciation is a higher figure than major repairs allowance meaning that:
- Councils may not be able to afford depreciation
  - This may demonstrate that the uprated major repairs allowance is insufficient and that the self-financing settlement will not provide sufficient resources for ongoing major repairs.
- 3.2.6 I will return to these matters after outlining the proposals in the consultation paper.

### **3.3 The Proposals**

- 3.3.1 The aims and objectives of the paper are:
- To set out a methodology for the calculation of depreciation which:
    - Is consistent with International Financial Reporting Standards
    - Is affordable to Housing Revenue Account business plans by not giving vastly different values to the long term component renewal and replacement costs in council housing
    - Where possible, minimises the additional administrative burden of data collection and analysis required to make an appropriate calculation
  - To set out proposals to ensure that authorities act appropriately in recognising the economic cost maintaining stock over the long term
  - To identify the entries required to the Housing Revenue Account and associated reserves to take effect from the date of self-financing.

- 3.3.2 Council houses are currently valued according to Existing Use Value for Social Housing that is based on Open Market Value discounted by a proportion to reflect the fact that the dwellings are let to social tenants with secure tenancies. International Financial Reporting Standards now require the identification of significant components within each dwelling and their separate treatment for depreciation. This means that there is a need to depreciate major building components (valued at gross replacement cost) and a residual value (Existing Use Value for Social Housing less the value of the components) that is a balancing figure that is expected to vary significantly from place to place and to be negative in many instances. It is not clear what this residual value actually represents in reality!
- 3.3.3 The consultation paper proposes that a number of components should be identified separately utilising asset maintenance and stock condition data and assigned a value, component life and remaining life. Components may be grouped together if they have a similar useful life. They should then be depreciated using the straight-line method.
- 3.3.4 For the residual element the consultation paper proposes that:
- “The value attributable to the residual (non-componentised) element can be assigned on the basis of an additional gross replacement cost calculated in line with the stock condition data.”*
- 3.3.5 I consider that it would be useful if the Chartered Institute of Public Finance & Accountancy could explain what they mean by this.
- 3.3.6 It is proposed that the depreciation charge will continue to be debited to the Housing Revenue Account and credited to the major repairs reserve.
- 3.3.7 On Impairment the consultation paper states that:
- “Impairment occurs when a specific event leads to a reduction in value of an asset. Where impairment occurs, International Financial Reporting Standards requires a provision for impairment, over and above any accumulated balance held in the revaluation reserve, to be charged to the Housing Revenue Account. If the impact on the revenue account is to be mitigated, new regulations would be required to enable the impairment to be reversed out.”*
- 3.3.8 I find this statement surprising as impairment is currently ‘reversed out’.
- 3.3.9 The consultation paper asks two specific questions about depreciation:
- This proposal requires impairment to be charged to the Housing Revenue Account, which under current regulations could not be reversed out. We are seeking comments on whether local authorities see this as a significant issue and, if so, how this could be mitigated.
  - This proposal charges depreciation to the Housing Revenue Account in relation to assets. Where an asset is funded from a source other than borrowing, it would still receive a depreciation charge. We are seeking comments on whether this would cause a significant adverse impact to the Housing Revenue Account compared to the current arrangements, remembering that even debt free authorities have an MRA charge.

### **3.4 Discussion**

- 3.4.1 I have participated in the discussions in the sub-group on the proposed methodology for calculating depreciation although I am not one of the authors of the consultation paper. This is clearly a complex area and an obvious solution does not appear to exist. Unfortunately, I remain confused about the proposals that have been put forward by the Chartered Institute of Public Finance & Accountancy and in particular about their potential effects on the Housing Revenue Account. I would like to suggest that further clarification is required as I outline below. I would also like to suggest an alternative approach.
- 3.4.2 In view of the danger that depreciation charges would be unaffordable for most local authorities I would suggest that further clarification would be helpful on:
- Exactly how Councils would be expected to calculate depreciation under the new system.
  - Whether this calculation would result, as now, in a depreciation charge that is significantly greater than the major repairs allowance that has been used to calculate the settlement value for self-financing.
  - How Impairment would be treated. It appears that this would become a real charge to the Housing Revenue Account and there are no resources provided for impairment as part of the self-financing settlement.
- 3.4.3 It appears to me that these proposals may be logically flawed because they are based on the depreciation of components at gross replacement cost, whereas council housing, in common with all social housing is valued at Existing Use Value for Social Housing. If we were looking at housing that was rented at market rents there would be no difficulty. It would be possible to value a house based on market value and then break this down into the land value, the cost of construction (the components at cost) and the surplus value that would accrue to the landlord. Each of these elements of the valuation would be meaningful and depreciation of the components based on gross replacement cost would be logical and affordable.
- 3.4.4 However, in the case of social housing the property value is based on Existing Use Value for Social Housing that is significantly lower than market value reflecting the fact that it is let to social tenants at below market rents. This results in the creation of this 'residual amount' that is difficult to define, explain or calculate depreciation for. It can even be a negative amount. I attended a meeting of the Public Finance & Management Board of the Chartered Institute of Public Finance & Accountancy in February 2011 at which the Chair of the Housing Panel explained these proposals. My perception was that even this group of experienced accountants struggled to understand the concepts. I am sure that explaining them to tenants or councillors would be even more difficult!

### **3.5 Conclusions**

- 3.5.1 This is perhaps, one of those areas where accounting is made difficult by the need to address accounting standards that are designed for the private sector and procedures for financial administration that are based in statute simultaneously. The solution may be to continue with the current solution: to calculate depreciation and impairment in accordance with accounting standards but then to 'reverse them out' and instead substitute a transfer to the Major Repairs Reserve that is based on what the Council needs to set aside for Major Repairs. In the absence of an annual calculation of the Major Repairs Allowance, this could be based on the Council's stock condition survey. If government needs reassurance that Councils would set aside sufficient there could be a minimum requirement to set aside the sum included in the self-financing settlement for Major Repairs, perhaps updated each year by a suitable inflation index.
- 3.5.2 I would suggest that the Chartered Institute of Public Finance & Accountancy provide further details of their proposals for the calculation and treatment of depreciation and impairment; and give further consideration to the option of continuing to 'reverse out' these charges and for Councils to make a contribution to the Major Repairs reserve based on the future need to spend as identified in stock condition surveys.

### **4. AWICS Representations**

- 4.1 'AWICS' has made representations to the Chartered Institute of Public Finance & Accountancy. These are appended to this briefing paper.

### **5. Conclusions**

#### **5.1 Introduction**

- 5.1.1 The purpose of this briefing paper is to summarise the proposals on the proposed capital finance arrangements under the new housing finance system that are being made by the Chartered Institute of Public Finance & Accountancy and to comment on them.

#### **5.2 Management of Debt**

- 5.2.1 The proposals contained in the consultation paper on management of debt appear to represent the most practical way forward in the current circumstances. They also allow authorities to adopt an alternative approach if they consider that this would be best in view of the local circumstances.
- 5.2.2 There is the issue of the treatment of Minimum Revenue Provision in the General Fund in currently debt-free authorities. My preferred solution to this matter would be for the making of Minimum Revenue Provision in the General Fund discretionary in the same way as it already is in the Housing Revenue Account.

### **5.3 Depreciation**

- 5.3.1 This is perhaps, one of those areas where accounting is made difficult by the need to address accounting standards that are designed for the private sector and procedures for financial administration that are based in statute simultaneously. The solution may be to continue with the current solution: to calculate depreciation and impairment in accordance with accounting standards but then to 'reverse them out' and instead substitute a transfer to the Major Repairs Reserve that is based on what the Council needs to set aside for Major Repairs. In the absence of an annual calculation of the Major Repairs Allowance, this could be based on the Council's stock condition survey. If government needs reassurance that Councils would set aside sufficient there could be a minimum requirement to set aside the sum included in the self-financing settlement for Major Repairs, perhaps updated each year by a suitable inflation index.
- 5.3.2 I would suggest the Chartered Institute of Public Finance & Accountancy provide further details of their proposals for the calculation and treatment of depreciation and impairment; and give further consideration to the option of continuing to 'reverse out' these charges and for Councils to make a contribution to the Major Repairs reserve based on the future need to spend as identified in stock condition surveys.

### **5.4 AWICS Representations**

- 5.4.1 'AWICS' has made representations to the Chartered Institute of Public Finance & Accountancy. These are appended to this briefing paper.

**Adrian Waite**  
**March 2011**

## About 'AWICS'

'AWICS' provides a full range of management consultancy and training services, principally to those who are involved in social housing.

Our mission statement is 'Independence, Integrity, Value'. We therefore provide training from an independent standpoint that is designed to help the client to achieve their objectives. We are passionate about working with the utmost integrity. We believe that we offer the best value for money that is available today!

And we publish the popular free e-newsletter for housing services – the 'AWICS Housing News'. We are big enough to make a difference – but are small enough to care!

We are currently assisting local authorities with the implementation of self-financing.

We also offer training in local authority housing finance through:

- Our series of regional seminars on 'All You Want to Know about Local Authority Housing Finance 2011'
- Our seminar on 'Developments in Local Authority Housing Finance 2011'
- Tailored in-house training

Each year we update our guide to local authority housing finance: 'All You Want to Know about Local Authority Housing Finance'. The 2011 edition is now available.

For more information about us and our services please visit our website at [www.awics.co.uk](http://www.awics.co.uk) or contact Adrian Waite at [Adrian.waite@awics.co.uk](mailto:Adrian.waite@awics.co.uk).

**Appendix – AWICS representations to the Chartered Institute of Public Finance & Accountancy**



*Adrian Waite (Independent Consultancy Services) Limited*

29<sup>th</sup> March 2011

Mr. Julian Smith,  
Finance and Policy Manager,  
Chartered Institute of Public Finance & Accountancy,  
3 Robert Street,  
Westminster,  
London.  
WC2N 6RL.

Dear Julian,

**Consultation on Proposed Capital Finance Arrangements under the New Housing Finance System**

Thank you for inviting me to comment on this consultation paper.

You have requested both general comments on the proposals as set out and comments on the specific issues highlighted.

General Comments – Management of Debt

1. I have participated in the discussions in the sub-group on the proposed methodology for splitting debt and it appears to me that the methodology put forward by the Chartered Institute of Public Finance & Accountancy represents the best possible way of achieving this in the current context.
2. It has been identified that where an authority is debt free it currently does not need to make a Minimum Revenue Provision (make repayments of debt) in the General Fund. This can arise where an authority has debt in the General Fund but not in the Housing Revenue Account. In such a case an increase in Housing Revenue Account debt could result in a need to make a Minimum Revenue Provision in the General Fund. It is understood that Communities & Local Government are giving consideration as to how this issue may be addressed.

3. I would suggest that this could be resolved by making it a matter for local discretion to determine whether or not to make a Minimum Revenue Provision in the General Fund in the same way as is already the case in the Housing Revenue Account. This would appear to be consistent with the principles of Localism.

#### Specific Issues – Management of Debt

- a) Comments are requested on whether Treasury Management systems will be able to manage two portfolios.

My understanding is that most authorities would be able to manage two portfolios.

- b) There may be authorities whose debt reduction exceeds their Public Works Loans Board borrowing, resulting in early settlement premiums becoming payable on market loans. We are seeking to establish how widespread this is and whether these authorities would seek to repay debt and what the potential costs might be.

I am not aware of the extent of this issue or of how individual authorities are proposing to address it.

- c) Debt free authorities may become liable to Minimum Revenue Provision, again we are seeking to establish how widespread this is and what the cost implications might be.

I would suggest that this problem could be overcome by making the Minimum Revenue Provision discretionary in the General Fund in the same way as it is in the Housing Revenue Account.

#### General Comments – Depreciation

1. I have participated in the discussions in the sub-group on the proposed methodology for calculating depreciation although I am not one of the authors of the consultation paper. This is clearly a complex area and an obvious solution does not appear to exist. Unfortunately, I remain confused about the proposals that have been put forward by the Chartered Institute of Public Finance & Accountancy and in particular about their potential effects on the Housing Revenue Account. I would like to suggest that further clarification is required as I outline below.
2. At present, charges for depreciation and impairment are made to the Housing Revenue Account. However, in practice these are notional charges as they are 'reversed out' of the account and the charge that is actually made to the account is the transfer of the Major Repairs Allowance to the Major Repairs Reserve. Usually, depreciation is greater than the Major Repairs Allowance and if impairment is charged this is totally 'reversed out'.

3. The introduction of self-financing means that there will no longer be an annual calculation of the Major Repairs Allowance. Resources for major repairs will, in theory, be built into the calculation of tenanted market value and there should therefore be sufficient resources in the rent stream to fund major repairs at the level that has been assumed in the self-financing settlement.
4. There is therefore a need to decide how Councils will determine how much to transfer into the Major Repairs Reserve. The amount needs to be sufficient to meet the cost of ongoing major repairs and also needs to be affordable. The proposal is that this should be achieved by using depreciation – with depreciation no longer being ‘reversed out’ and becoming a real charge to the Housing Revenue Account.
5. Advocates of this approach argue that depreciation is a good measure of the need to set resources aside for major repairs. For example, if new kitchens on an estate cost £300,000 and are estimated to last thirty years, depreciation of £10,000 a year should be sufficient to create a reserve to replace the kitchens when this is due. However, this approach is seen as having two disadvantages: First, it is argued that this is not logical given that Council housing is valued on the basis of Existing Use Value for Social Housing rather than at Market Value (see below) and Second, that depreciation is a higher figure than major repairs allowance meaning that:
  - Councils may not be able to afford depreciation
  - This may demonstrate that the updated major repairs allowance is insufficient and that the self-financing settlement will not provide sufficient resources for ongoing major repairs.
6. In view of the danger that depreciation charges would be unaffordable for most local authorities I would suggest that further clarification would be helpful on:
  - Exactly how Councils would be expected to calculate depreciation under the new system.
  - Whether this calculation would result, as now, in a depreciation charge that is significantly greater than the major repairs allowance that has been used to calculate the settlement value for self-financing.
  - How Impairment would be treated. It appears that this would become a real charge to the Housing Revenue Account and there are no resources provided for impairment as part of the self-financing settlement.

7. It appears to me that these proposals may be logically flawed because they are based on the depreciation of components at gross replacement cost, whereas council housing, in common with all social housing is valued at Existing Use Value for Social Housing. If we were looking at housing that was rented at market rents there would be no difficulty. It would be possible to value a house based on market value and then break this down into the land value, the cost of construction (the components at cost) and the surplus value that would accrue to the landlord. Each of these elements of the valuation would be meaningful and depreciation of the components based on gross replacement cost would be logical and affordable.
8. However, in the case of social housing the property value is based on Existing Use Value for Social Housing that is significantly lower than market value reflecting the fact that it is let to social tenants at below market rents. This results in the creation of this 'residual amount' that is difficult to define, explain or calculate depreciation for. It can even be a negative amount. I attended a meeting of the Public Finance & Management Board of the Chartered Institute of Public Finance & Accountancy in February 2011 at which the Chair of the Housing Panel explained these proposals. My perception was that even this group of experienced accountants struggled to understand the concepts. I am sure that explaining them to tenants or councillors would be even more difficult!
9. This is perhaps, one of those areas where accounting is made difficult by the need to address accounting standards that are designed for the private sector and procedures for financial administration that are based in statute simultaneously. The solution may be to continue with the current solution: to calculate depreciation and impairment in accordance with accounting standards but then to 'reverse them out' and instead substitute a transfer to the Major Repairs Reserve that is based on what the Council needs to set aside for Major Repairs. In the absence of an annual calculation of the Major Repairs Allowance, this could be based on the Council's stock condition survey. If government needs reassurance that Councils would set aside sufficient there could be a minimum requirement to set aside the sum included in the self-financing settlement for Major Repairs, perhaps updated each year by a suitable inflation index.
10. I would suggest that the Chartered Institute of Public Finance & Accountancy provide further details of their proposals for the calculation and treatment of depreciation and impairment; and give further consideration to the option of continuing to 'reverse out' these charges and for Councils to make a contribution to the Major Repairs reserve based on the future need to spend as identified in stock condition surveys.

### Specific Issues - Depreciation

- a) This proposal requires impairment to be charged to the Housing Revenue Account, which under current regulations could not be reversed out. We are seeking comments on whether local authorities see this as a significant issue and, if so, how this could be mitigated.

This does appear to be a significant issue. I would suggest that it should be mitigated by allowing local authorities to continue to 'reverse out' any impairment before calculating the balance on the Housing Revenue Account.

- b) This proposal charges depreciation to the Housing Revenue Account in relation to assets. Where an asset is funded from a source other than borrowing, it would still receive a depreciation charge. We are seeking comments on whether this would cause a significant adverse impact to the Housing Revenue Account compared to the current arrangements, remembering that even debt free authorities have an MRA charge.

There is the potential for depreciation to have an adverse effect on the Housing Revenue Account whether an asset has been financed by borrowing or in another way. This matter is considered above.

### Conclusions

I hope that you find these observations helpful.

This letter is sent by email and as a hard copy.

Yours sincerely,

**Adrian Waite**  
**Managing Director**