



## Local Authority Accounting Panel Bulletin 47

### Resource Accounting in the HRA Shadow Accounting Guidance (England) 2000-2001

#### 1. INTRODUCTION

1.1 The Government has decided to introduce, in England, a form of resource accounting in the Housing Revenue Account (HRA) from 1 April 2001.

1.2 The objectives of this were spelt out in the Department of the Environment, Transport and the Regions (DETR) consultation paper of December 1998 'A new financial framework for local authority housing : resource accounting in the Housing Revenue Account':

- encourage more efficient use of housing assets
- increase the transparency of the HRA
- assist authorities in planning their housing strategy
- bring council housing onto a more directly comparable basis with Registered Social Landlords
- achieve consistency with central government resource accounting and budgeting
- achieve consistency with authorities' other revenue accounts
- put authorities' housing accounts on a more businesslike basis

1.3 As an intrinsic part of the preparation for the introduction of resource accounting in the HRA, CIPFA has been asked by DETR to publish accounting guidance for practitioners for shadow running in 2000/2001. This bulletin provides guidance for shadow running of resource accounting in 2000/2001.

1.4 The purpose of shadow running in 2000/2001 is to assist local authorities with their own preparations for the introduction of resource accounting in the HRA in the 2001/2002 accounts. The DETR has advised that the Government will not be collecting information from shadow accounting. Shadow running is an integral part of good practice for the process of the introduction of resource accounting in the HRA.

1.5 The DETR has established a specific 'new financial framework' website within the housing section of ([www.detr.gov.uk](http://www.detr.gov.uk)). It is intended that this will hold electronic versions of all current and future DETR papers relating to the movement of the HRA to a resource accounting basis.

## 2. BASE DATA FOR SHADOW RUNNING

- 2.1 Resource accounting in the HRA is scheduled to become operational in 2001/2002. In the meantime, the current system continues and will form the base data for shadow accounting.
- 2.2 Local authorities are advised to start with a current set of accounts and to examine what changes will be necessary to these for the new system.
- 2.3 The 1999/2000 accounts will be closed during the summer of 2000. It is recommended that these accounts are used to form the base data for shadow running in 2000/2001.
- 2.4 The possibility of using the 2000/2001 budget figures for the base data for shadow closure has been discussed but is not recommended because the same information is not required for budget setting as for accounts closure.
- 2.5 The base data for the shadow closure of the HRA accounts will be that required in the Code of Practice on Local Authority Accounting (the SORP). The requirements for the HRA in the 2000 SORP are the same as those for the 1999 SORP and are as follows:

### **"THE HOUSING REVENUE ACCOUNT: ENGLAND AND WALES"**

- 4.23 The Housing Revenue Account reflects a statutory obligation to account separately for local authority housing provision, as defined in particular in Schedule 4 of the Local Government and Housing Act 1989. It shows the major elements of housing revenue expenditure - maintenance, administration, rent rebates - and capital financing costs, and how these are met by rents, subsidy and other income.

### **Information to be included in the accounting statement**

- Income
  - Dwelling rents (gross)
  - Non-dwelling rents (gross)
  - Charges for services and facilities
  - Contributions towards expenditure
  - Housing Revenue Account subsidy receivable
  - Housing Benefit transfers
  - Credits from housing repairs account
- Interest
  - Mortgage interest
  - Interest on cash balances
- Transfer from General Fund

- Expenditure

- Repairs and maintenance or contribution to housing repairs account
- Supervision and management
- Rents, rates, taxes and other charges
- Rent rebates
- Housing Revenue Account subsidy payable
- Bad or doubtful debts
- Capital financing costs
- Capital expenditure charged to revenue

- Change in reserve balance

- Information to be disclosed in notes to the account

- (a) The number and types of dwelling in the authority's housing stock.
- (b) The amount of rent arrears (excluding amounts collectable on behalf of other agencies) and the aggregate balance sheet provision in respect of uncollectable debts.
- (c) The nature and amount of any exceptional or prior year items not disclosed in the statement.
- (d) An analysis of the movement on the housing repairs account, where appropriate."

It should be noted that the capital charges for the HRA are required to be calculated in accordance with the statutory item 8 determination.

The changes which are necessary to this base data for the shadow accounts are described in the sections which follow.

### 3. CHANGES WHICH WILL BE REQUIRED FOR SHADOW CLOSURE OF THE ACCOUNTS

3.1 The main accounting change which will be introduced by the new financial framework for the HRA is in the manner in which capital charges will be calculated and treated. The accounting treatment of these therefore predominates in this guidance.

3.2 The accounting entries covered in this guidance note are:

- overview of format of the HRA accounting statement
- valuations for the consolidated balance sheet
- capital charges - notional interest
- capital charges - depreciation - council dwellings
- capital charges - depreciation - HRA assets other than council dwellings
- housing set aside (HRA's contribution to minimum revenue provision)

- capital expenditure charged to revenue
- impairment
- revaluations
- disclosure notes
- rent rebates
- negative subsidy

3.3 Practitioners should note that the DETR has begun a review of the item 8 determination through a technical advisory group with representatives from central and local government and the Audit Commission. CIPFA is involved in this review. DETR intend to consult separately on the item 8 determination later in the year.

#### 4. OVERVIEW OF FORMAT OF THE HRA ACCOUNTING STATEMENT

4.1 The current format of the HRA accounting statement is divided into income and expenditure, resulting in the change in reserve balance, ie the surplus or deficit for the year (as shown in section 2 above).

4.2 Under resource accounting, the statement will have three main divisions:

- net cost of services (income and expenditure)
- net operating expenditure
- appropriations.

4.3 For the shadow accounts, in the first instance retitle all of the current income and expenditure entries as the net cost of services. During shadow running, movements to/from the asset management revenue account (AMRA) will be transferred below the net cost of services but within net operating expenditure. Movements to/from the capital financing reserve (CFR) will be transferred to the appropriations section of the account. This is consistent with the current requirements for all other local authority services. Detailed guidance on the operation of the asset management revenue account and other aspects of capital accounting can be found in CIPFA's Consolidated guidance notes for practitioners - capital accounting by local authorities published in 1999.

4.4 Because the shadow accounts are starting with a set of accounts prepared to the current accounting arrangements rather than from scratch, some of the accounting entries needed for the shadow accounts will be different from those required for live resource accounting. Where this is the case, this is highlighted in the text. Details for the accounting entries for resource accounting in the HRA will be provided by CIPFA in the accounting guidance which will be published for the 2001/2002 accounts.

#### 5. VALUATIONS FOR THE CONSOLIDATED BALANCE SHEET

5.1 The DETR 1998 consultation paper on the new financial framework for the HRA considered two alternative bases of valuation for council dwellings : existing use value as social housing (EUV-SH) and open market value (OMV).

CIPFA and others recommended that EUV-SH is the appropriate basis for the valuation of council housing for the balance sheets of local authorities. The SORP requires, for the operational assets of a local authority, the valuation basis within the local authority's accounts to be the lower of net current replacement cost and net realisable value in existing use : for social housing this is existing use as social housing.

5.2 In the event the Minister's decision, announced on 22 June 1999 was:

"On the question of the basis to be adopted for valuing housing stock for the cost of capital charge in the account, respondents overwhelmingly favoured existing use value as social housing, rather than open market value. I confirm that this will be the basis for valuation."

CIPFA supports this outcome. It means that the valuation basis required by the DETR for the HRA is the same as that required by the SORP for the consolidated balance sheet and the same valuation can be used for both purposes.

5.3 Within the current accounting framework, several different methods are permissible for the valuation of council housing stock for the local authority's balance sheet. However, the DETR has prescribed a single valuation methodology to be used in the new financial framework being introduced from 1 April 2001. DETR set out the valuation method to be followed in A new financial framework for local authority housing - guidance on stock valuation published in May 2000. The DETR propose to make a direction requiring compliance with its valuation guidance. The DETR will be consulting authorities on this.

5.4 The executive summary in the front of the DETR guidance states:

"This Guidance advises local authorities on the bases and methods of valuation for the Housing Revenue Account (HRA) assets on the introduction of resource accounting.

The basis of valuation for the bulk of the housing stock within the HRA is Existing Use Value for Social Housing (EUV - SH) as defined by the Royal Institution of Chartered Surveyors Appraisal and Valuation Manual. One method of valuation is prescribed in the Guidance to arrive at EUV-SH, based on the vacant possession value of the properties, adjusted to reflect the occupation by a secure tenant.

The general principles and process to follow when using this method are fully described. Authorities may wish to adapt the process to meet their individual requirements, but the general principles and the key stages should be adopted, albeit in various forms.

Guidance to the valuation of non-housing and miscellaneous assets is also provided. These assets are expected to form a small part of the HRA properties by number and value. The resources devoted to preparing these

valuations should have regard to the materiality of the effect of these values on the accuracy of the total HRA assets."

Practitioners are referred to the DETR guidance for details of the method to be used.

- 5.5 In undertaking the valuations, practitioners should comply with the Code of Practice for Local Authority Accounting in the United Kingdom 2000 (the 2000 SORP). The 2000 SORP incorporates the requirements of the Accounting Standard Board Financial Reporting Standard 15, Tangible fixed assets (FRS 15). This does not change the requirements for the bases of valuations to be used for the balance sheets of local authorities. It clarifies and includes the requirement that

"A full valuation of a property is conducted by either a qualified external valuer or a qualified internal valuer. A qualified valuer is a person conducting the valuations who holds a recognised and relevant professional qualification and having recent post-qualification experience, and sufficient knowledge of the state of the market, in the location and category of the tangible fixed asset being valued."

FRS 15 requires that where an internal valuer is used the valuation must be subject to a review by a qualified external valuer which involves the valuation of a sample of properties. However, this is not required by the local authority accounting SORP and either an external valuer or an internal valuer (with no external review) can be used. This approach was consulted on formally during the preparation of the 2000 SORP, has been approved, and specifically endorsed by the ASB during their negative assurance review of the SORP.

- 5.6 Once the valuation using the required methodology has been completed, this should be included within the accounts of the local authority.
- 5.7 For the shadow accounts, the local authority should use the existing valuation in the balance sheet; and also consider the difference which the new valuation would make to the account once this has been completed.

## 6. CAPITAL CHARGES - NOTIONAL INTEREST

- 6.1 The new system of resource accounting in the HRA will require that a charge is made to the HRA for the use of HRA fixed assets. The charge will be determined by applying a specified notional rate of interest to the net amount at which the asset is held in the balance sheet. This is consistent with current practice for all other operational local authority assets. The specified notional rate of interest is determined annually by the CIPFA/LASAAC Joint Committee. For assets valued at current value, which includes council housing, the rate is 6%. The SORP will allow the opening or closing balance of the HRA's fixed assets, or an average of the two to be used as the basis for the calculations, provided that it is used consistently each period. This is consistent with the requirements of generally accepted accounting practice in the private sector for the charging of depreciation. CIPFA guidance

recommends that the opening balance sheet approach, with adjustments for major changes arising in the year should normally be adopted.

- 6.2 The capital charges made to the HRA are the statutory capital financing charges calculated in accordance with the item 8 determination. Currently this does not include a notional interest charge, but as mentioned earlier the item 8 debit is being reviewed and will include for the 2001/02 financial year both notional interest and depreciation. Under resource accounting, the notional interest element of the capital charge will be charged to the expenditure section of the HRA within net cost of services and reversed out via the asset management revenue account. "Actual" interest "paid" by the HRA as determined by the item 8 determination will be charged to the asset management revenue account. The accounting treatment of the other components of the item 8 debit such as debt management expenses and amortised premiums is being further considered and detailed guidance will be given before the commencement of resource accounting in 2001. The accounting treatment of housing set aside/minimum revenue provision is given later in this guidance. For the purpose of shadow accounting authorities should only make the adjustments noted in this guidance.
- 6.3 Thus, in summary, it is expected that when resource accounting becomes operational in 2001, the notional interest element of the capital charge will form part of the revised item 8 determination; that the notional interest element of the capital charge will be charged to the expenditure section of the HRA within net cost of services; and that this will be replaced below the net cost of services but within net operating expenditure via the asset management revenue account with the "actual" interest "paid" by the HRA calculated in accordance with the revised item 8 determination.
- 6.4 For the shadow accounts, because an existing set of accounts where the item 8 determination has already been made are being used to provide the base data, a different set of entries are required:

Dr HRA net cost of services  
Cr Asset management revenue account

(a) To charge net cost of services with the notional interest element of the capital charges.

Dr Asset management revenue account  
Cr HRA below net cost of services, within net operating expenditure

(b) To reverse out the notional interest element of the capital charges below net cost of services.

Dr HRA below net cost of services, within net operating expenditure  
Cr HRA net cost of services

(c) To charge the "actual" interest "paid" by the HRA in accordance with the item 8 determination below net cost of services instead of within net cost of services.

Dr HRA net cost of services

Cr HRA below net cost of services, within net operating expenditure

(d) To credit the "interest receivable" under the item 8 credit determination below net cost of services instead of within net cost of services.

6.5 During shadow running, practitioners are advised to note the difference that including the notional interest element of the capital charge, which is a charge for the use of capital, will make to their reported cost of HRA services, as this may affect performance indicators and best value evaluations. The surplus or deficit for the year will, however, be unaffected.

## 7. CAPITAL CHARGES - DEPRECIATION - COUNCIL DWELLINGS

7.1 Currently, many local authorities are not depreciating their council housing stock. For those who do depreciate their housing stock, this is primarily a balance sheet consideration because the capital charges made to the HRA are those required by the statutory item 8 determination which does not include an element for depreciation. This dichotomy causes practical difficulties on consolidation for the local authority's consolidated revenue account, and detailed guidance on this point is included in chapter 10 of CIPFA's consolidated guidance notes for practitioners on capital accounting, published in 1999.

7.2 Under resource accounting, all local authorities' housing stock must be considered for depreciation.

7.3 The DETR has had discussions with CIPFA and the Accounting Standards Board about the major repairs allowance and depreciation. This issue has now been resolved. The CIPFA/LASAAC Joint Committee has accepted the major repairs allowance as a reasonable estimate measure of depreciation for use by chief finance officers in fulfilling their professional obligations to comply with the SORP. If, in the professional opinion of the chief finance officer concerned, another depreciation approach is more appropriate for council dwellings in that particular authority, an alternative method of depreciation should be used in the accounts. If, in the future, the methodology of the major repairs allowance changes significantly, then the CIPFA/LASAAC Joint Committee would review matters to ascertain whether or not the major repairs allowance continues to be a reasonable estimate measure of depreciation.

7.4 Under resource accounting in the HRA, depreciation of council dwellings will be a charge to the net cost of services. Unlike the situation for the general fund of local authorities where, for the amount to be met from government grants and local taxpayers, depreciation is effectively reversed out and replaced with the statutory minimum revenue provision (MRP), it is intended that depreciation for council dwellings will "hit the bottom line" and be a real

charge on the HRA. This will be resourced through the major repairs allowance (MRA) which will be a part of the housing subsidy.

7.5 Guidance on the detailed accounting entries which will be required to accomplish this under resource accounting will be published in a further LAAP bulletin later in the year.

7.6 For shadow accounting, local authorities are advised to

- consider the illustrative MRA figure for their authority which the DETR intends to publish this summer
- consider the reasonableness of the illustrative MRA figure as a measure of depreciation for their housing stock
- consider the uses to which the MRA could be put
- consider the impact of the MRA on their net cost of services since this may affect performance indicators and best value considerations
- consider the impact on their budget.

It is suggested that in order to facilitate this, for shadow running until further guidance is published, the major repairs allowance is simply included within both the income and expenditure elements of the net cost of services. This is without prejudice to the final accounting entries or to the use by the authority of the major repairs allowance and is intended to assist consideration of the above points.

7.7 The resource implications where a local authority uses a measure of depreciation other than the major repairs allowance are being further considered by the DETR. The DETR has indicated that their current view is that:

- Where depreciation for council dwellings is higher than the major repairs allowance, the principle of depreciation being a real charge to the account should apply. This would mean that local authorities would have to fund any difference if they make a depreciation charge higher than the major repairs allowance. This would be charged as an expense to the HRA.
- Where depreciation for council dwellings is lower than the major repairs allowance, then the HRA would show a surplus for the year. The DETR intends that the surplus would represent major repairs allowance that needs to be spent on stock maintenance.

## 8. CAPITAL CHARGES - DEPRECIATION - HRA ASSETS OTHER THAN COUNCIL DWELLINGS

8.1 Where such assets are material, local authorities will have HRA operational assets on their balance sheet other than council housing. If a local authority has HRA operational assets on the balance sheet other than council dwellings, then these must be considered for depreciation. Currently, the situation for these assets is as described in paragraph 7.1 above - although a

review will be necessary for the 2000/2001 accounts because of the inclusion of the provisions of FRS 15 within the SORP. As a consequence, in the 2000 SORP for fixed assets other than non-depreciable land and non-operational investment properties, the only ground for not charging depreciation is that the depreciation charge is immaterial.

8.2 Under resource accounting, there are several potential options to deal with the depreciation of assets not covered by the major repairs allowance in the item 8 determination and these are being considered further by the DETR.

8.3 For the purposes of shadow running the current accounting arrangements should be presumed to continue. Therefore no additional accounting entries are required for shadow running. Local authorities are however advised to estimate the total amounts which would be involved in accordance with the provisions of FRS 15 as now included within the SORP.

## 9. HOUSING SET ASIDE (HRA'S CONTRIBUTION TO MINIMUM REVENUE PROVISION)

9.1 The requirement for the HRA to make the housing set aside/minimum revenue provision for the provision of credit liabilities (PCL) will continue into the new financial framework.

9.2 Under resource accounting the entries which will be required are

Dr HRA appropriations section  
Cr Capital financing reserve  
To make the charge to the HRA for housing set aside/MRP.

9.3 For the shadow accounts, the set aside/MRP will already have been made through the item 8 determination. The accounting entries for shadow running are

Dr HRA appropriations section  
Cr HRA net cost of services

To transfer housing set aside/MRP from the net cost of services to the appropriations section of the account.

## 10. CAPITAL EXPENDITURE CHARGED TO REVENUE

10.1 Currently within the HRA, capital expenditure charged to revenue is charged within the net cost of services. This is inconsistent with what happens in the general fund and with the principles of capital/resource accounting. Under resource accounting, capital expenditure charged to revenue will be charged within the appropriations section of the account. Fixed assets financed directly from revenue will be valued for the balance sheet and a capital charge calculated in the same way as all other HRA fixed assets. Under resource accounting, as now, capital expenditure charged to revenue will not be a part of the calculation for housing subsidy.

10.2 Under resource accounting the accounting entries will be

Dr HRA appropriations section  
Cr Capital financing reserve  
To finance capital expenditure from revenue.

10.3 For shadow running, since this expenditure will already have been charged to the HRA within the net cost of services, the entries are

Dr HRA appropriations section  
Cr HRA net cost of services

To transfer capital expenditure financed from revenue from the net cost of services to the appropriations section of the account.

## 11. IMPAIRMENT

11.1 DETR in partnership with local authorities, the Audit Commission and CIPFA are reviewing the item 8 debit. This review will also consider how impairment should be reflected.

11.2 No accounting entries are needed for impairment for shadow running.

## 12. REVALUATIONS

12.1 HRA assets are subject to the requirements for revaluations for fixed assets given in the SORP. There is detailed guidance in respect of HRA assets in the chapter on revaluations and valuation reviews in the recent DETR guidance on stock valuations. CIPFA was consulted during the preparation of this guidance and, whilst the guidance is more prescriptive than the SORP, CIPFA is not aware of any contradiction between it and the SORP. In the event of any conflict between sources, practitioners are reminded of the following hierarchy:

- the SORP constitutes the statement of recommended practice for local authorities and is proper practice under the Local Government and Housing Act 1989. It takes precedence over guidance.
- in the unusual circumstance that the SORP conflicts with statute, the statutory requirements take precedence.

12.2 Under resource accounting, as now, the accounting entries required on revaluation are

either

Dr Fixed asset  
Cr Fixed asset restatement reserve

Revaluation where the value of the fixed asset increases

or

Dr Fixed asset restatement reserve

Cr Fixed asset

Revaluation where the value of the fixed asset decreases.

- 12.3 Since these entries will already have been made, if necessary, within the accounts being used as the base data for shadow running, no further accounting entries are needed for shadow running.
- 12.4 Practitioners are reminded that "backlog depreciation" is not a feature of local authority accounting. Rather, where an asset is revalued (or the useful life of the fixed asset changes) the carrying amount of the fixed asset is depreciated over the (revised) remaining useful life. This is consistent with FRS 15.

### 13. DISCLOSURE NOTES

- 13.1 The DETR's original 1998 consultation paper on resource accounting in the HRA proposed that, under resource accounting, there should be a notional balance sheet for the HRA. As a result of the consultation, it has been decided that this will not be the case. Instead, the DETR has indicated that the following additional disclosures will be required as notes to the HRA.

For all HRA assets, the opening and closing balances for:

- Fixed assets
- Operational assets
- Council dwellings (if any)
- Other land and buildings (if any)
- Vehicles, plant, furniture and equipment (if any)
- Infrastructure assets (if any)
- Community assets (if any)
- Non operational assets (if any)
- Deferred charges (if any).

- 13.2 The DETR has also indicated that the following additional disclosures will be required under resource accounting:
- vacant possession value of council dwellings as detailed in paragraphs 12.4.1 - 12.4.3 of the DETR guidance on stock valuation
  - use of MRA in year and balance remaining
  - analysis of the HRA subsidy entitlement into its main components
  - summary of capital expenditure and disposals during the year, including assets acquired under finance leases, analysed for each category of fixed assets, together with the sources of finance
  - an explanatory note about the capital charges made.

13.3 For the shadow accounts, these additional disclosure notes should be prepared, with the exception of the

- vacant possession value of council dwellings
- use of MRA in year and balance remaining.

#### 14. RENT REBATES

14.1 The letter of the DETR to all chief finance officers of local housing authorities in England dated 23 May 2000 includes the following information on rent rebates

"On the handling of rent rebates under resource accounting, Ministers have decided, in the light of consultation responses, to confirm their intention to introduce the pooling of assumed HRA surpluses, once rent rebates are removed from the HRA. That will require legislation, and the measures will be introduced when Parliamentary time is available."

14.2 No action is necessary on rent rebates for the shadow accounts in 2000/2001. Revised accounting guidance will follow the new statutory requirements when the legislation is enacted.

#### 15. NEGATIVE SUBSIDY

15.1 A local authority which, notionally, is in receipt overall of negative housing subsidy is required under section 80(2) of the Local Government and Housing Act 1989 to carry the equivalent positive amount from their HRA to their general fund. For some local authorities, the annual transfers are substantial. The implication of the new financial framework is that in future such transfers will be back to a national 'pool' rather than within the local authority.

15.2 As mentioned in paragraph 14.1 above, the proposed new pooling arrangements cannot be introduced until Parliamentary time has been found for the necessary amendments to legislation. In the meantime, the introduction of the MRA in 2001/2002 will have the effect of generally reducing negative subsidy levels, and consequently the amounts of transfers to the general fund. The DETR has confirmed that there will be transitional measures for overall negative subsidy authorities from April 2001 and that they will be consulting separately on the detail of these measures.

15.3 No accounting entries are necessary for the shadow accounts but local authorities will, as always, need to consider implications of the DETR proposals on their budget.

<<Download Appendix>>

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