



Local Authority Accounting Panel Bulletin 48

Resource Accounting in the HRA (England) Shadow Accounting Guidance 2000-2002 MRA and Depreciation

1. INTRODUCTION

1.1 This bulletin is a follow-up to LAAP bulletin 47 which was published in July. The two bulletins should now be read together.

1.2 This follow-up bulletin contains further details for local authorities in relation to accounting entries for the major repairs allowance (MRA) and for depreciation, for shadow running during 2000-2001 in preparation for the introduction of resource accounting in the HRA from 1 April 2001.

2. ACCOUNTING FOR THE MRA AND DEPRECIATION — DESCRIPTION

2.1 Under resource accounting, local authorities will receive the major repairs allowance (MRA) as a part of housing subsidy. This will involve the receipt of cash. For local authorities in receipt of positive housing subsidy, this will be a cash payment as part of the housing subsidy. For local authorities in notional receipt of negative housing subsidy, the negative subsidy will be less than would otherwise have been the case. This will result, once it is established, in less payment to the new national “pool”, ie a cash situation which will be greater by the amount of the MRA than would otherwise have been the case. In the short term, cash for negative subsidy authorities will be increased by means of a lower contribution to rent rebates and/or general fund. The receipt of the MRA will be income to the HRA within net operating expenditure.

2.2 Under resource accounting, the HRA within net cost of services will be charged with a capital charge which will include depreciation calculated in accordance with FRS 15 and the local authority accounting SORP. The depreciation charged will reduce the value for net fixed assets. It is not a cash transaction.

2.3 Within the private sector, the charging of depreciation to the profit and loss account serves to retain cash within the business relating to the wearing out of fixed assets. It is not generally the practice to account for this in a separate reserve. The cash is a cash resource that is available for use by the business. It is tracked through the cashflow statement.

2.4 Within the consolidated revenue accounts of local authorities, currently depreciation charged to services is replaced for the charge to taxation and

general grant with the statutory requirement for the repayment of debt, the MRP. If MRP is zero, then the charge to the bottom line is zero. If MRP is £500,000 then the charge to the bottom line is £500,000. [NB unless the local authority determine to make a voluntary addition for the repayment of debt.] In any event, currently the charging of depreciation within a local authority's account does not result in the creation of cash retained for use by the authority, other than for the repayment of debt as statutorily determined. This is achieved within the appropriations section of the account where depreciation is replaced with the MRP (often referred to as "reversing out depreciation and replacing it with MRP"). The accounting entry to achieve this is a debit or credit to the capital financing reserve.

- 2.5 However, the intention of resource accounting is that the MRA will be retained as cash available for use by the HRA on fixed assets. (Assume for the moment that the depreciation so charged equates to the MRA - other amounts are considered later in this bulletin). The depreciation charged will not be part of the reversal to the capital financing reserve for MRP/housing set aside. Thus, the HRA will be charged with the housing set aside AND depreciation for council houses. Thus, depreciation for council houses will "hit the bottom line" once it has been charged to services. No other accounting entries would be necessary in order to achieve this.
- 2.6 However, to avoid a "double hit" on the bottom line (depreciation and expenditure of MRA funds on fixed assets) it is necessary to devise arrangements that ensure that the expenditure of the cash generated by the MRA is not, due to statute, required to be charged to the HRA. Also, for policy reasons, tracking of the use of the MRA by the authority in a way which is transparent and auditable is desired.
- 2.7 The DETR will be consulting on proposals for changes to secondary legislation. These proposals would:
 - (a) amend the Accounts and Audit Regulations 1996 to require authorities effectively to keep a major repairs reserve
 - (b) amend the Capital Finance Regulations 1997 so that expenditure of the funds in the major repairs reserve does not need to be charged to the housing revenue account
 - (c) amend the item 8 determination to ensure that a sum not less than the MRA is transferred to the major repairs reserve
 - (d) amend the item 8 determination to require authorities to take account of transactions in the major repairs reserve in calculating their notional cash balance.
- 2.8 The accounting entries in this bulletin are consistent with the statutory framework proposed and with the policy aims of introducing resource accounting in the HRA. The accounting entries are similar in nature to those for capital receipts. Local authorities will be aware that CIPFA has

recommended to the government that, longer term, consideration is given to moving fully to a GAAP basis for depreciation and capital receipts, following full consideration of the resource implications. Meanwhile, the approach adopted for the major repairs reserve is similar to that already adopted for the useable capital receipts reserve, thus building on current accounting practice, whilst meeting the statutory and policy requirements.

2.9 If during shadow running in 2000-2001, any currently unforeseen difficulties in the approach adopted are revealed, local authorities are requested to let CIPFA know as a matter of urgency.

3. ACCOUNTING FOR THE MRA AND DEPRECIATION – WHERE MRA IS EQUAL TO DEPRECIATION

3.1 The receipt of the MRA has increased cash. The charging of depreciation equal to MRA has retained that cash within the authority. This cash should be “put” into the major repairs reserve. The cash is already there within the balance sheet; the effect is to earmark it (put it in a “piggy bank” / useable reserve) until it is used to finance capital expenditure. This can be achieved through an adjustment with the capital financing reserve. The cash is then backed in the balance sheet by a useable capital reserve, the major repairs reserve. An exemplification is given in exemplification 1 in the appendix to this bulletin.

3.2 When the expenditure to be financed from the major repairs reserve is incurred, it will be capitalised rather than being a charge to services. The MRA calculation separately depreciates each component of the council dwellings other than land. Therefore, it follows that expenditure on those items by the local authority would constitute capital expenditure as defined in FRS 15, and thus be proper practice within the local authority accounting SORP. Further, the DETR advise that it is also consistent with the definition of capital expenditure in Part IV of the Local Government and Housing Act 1989.

4. ACCOUNTING FOR THE MRA AND DEPRECIATION – WHERE DEPRECIATION CHARGED IS LESS THAN MRA

4.1 Turning now to the situation where depreciation charged is less than MRA. The MRA is received as income as part of the housing subsidy. The HRA is charged with depreciation in the expenditure section that is less than MRA. This is exemplified in exemplification 2 in the appendix to this bulletin. The net cost of services is less than in exemplification 1. Unless a transfer is made in the appropriations section, the surplus on the HRA is greater. However, it is the DETR's view that where depreciation is less than MRA, then a sum equivalent to the full amount of the MRA should be transferred to the major repairs reserve, and the DETR will be consulting on requiring this through secondary legislation. Entries would therefore need to be made in the appropriations section of the account as shown in exemplification 2. These entries bring the surplus back to the same amount as in exemplification 1.

- 4.2 When the expenditure to be financed from the major repairs reserve is incurred, it will be capitalised rather than being a charge to services.
5. ACCOUNTING FOR THE MRA AND DEPRECIATION – WHERE DEPRECIATION OF COUNCIL HOUSES IS GREATER THAN MRA
- 5.1 When depreciation charged for council houses is more than MRA, the reverse applies. Again the MRA is income to the account and depreciation is expenditure. But in this case, the net cost of services is greater than in exemplification 1. Two exemplifications are given in the appendix for this scenario. In exemplification 3, a sum equivalent to the full depreciation charge is channelled into the major repairs reserve. This reflects DETR's view where depreciation on council houses is greater than the MRA a sum equivalent to the full depreciation charge should be taken to the major repairs reserve, in order to make adequate provision for maintaining the value of the assets. This is also more consistent with generally accepted accounting practice. It would have policy and resource implications that would need to be fully considered and the DETR will be consulting local authorities on this matter. In exemplification 3A, entries are made in the appropriations section which bring the surplus back to the same amount as in exemplification 1, and which would mean that a sum equivalent to the MRA only is channelled into the major repairs reserve.
- 5.2 For shadow accounting purposes, local authorities should follow exemplification 3; exemplification 3A is included for information only at this stage.
- 5.3 When the expenditure to be financed from the major repairs reserve is incurred, it will be capitalised rather than being a charge to services.
6. ACCOUNTING FOR THE MRA AND DEPRECIATION – WHERE A DEPRECIATION CHARGE IS MADE IN RESPECT OF HRA ASSETS NOT COVERED BY THE MRA
- 6.1 A similar situation arises in respect of depreciation charged within the HRA for assets other than council housing, for example for garages and shops. It is the DETR's view that this depreciation should be funded from the income from such properties. This is also more consistent with generally accepted accounting practice. It would have policy and resource implications that would need to be fully considered and the DETR will be consulting local authorities on this matter. Exemplification 4 in the appendix shows an amount of cash channelled into the major repairs reserve equivalent to the depreciation on council houses (in this case equivalent to the MRA) plus the depreciation on other HRA assets. In the exemplification shown, this impacts on the surplus. Alternatively, the income from the properties concerned (shops, offices etc) could be increased. Exemplification 4A shows what would happen if the depreciation for properties other than council houses is reversed out through the appropriations section.

6.2 For shadow accounting purposes, local authorities should follow exemplification 4; exemplification 4A is included for information only at this stage.

6.3 When the expenditure to be financed from the major repairs reserve is incurred, it will be capitalised rather than being a charge to services.

7. ACCOUNTING FOR THE MRA AND DEPRECIATION – JOURNAL ENTRIES

7.1 A key job for the appropriations section of the revenue account is to reconcile charges made in accordance with generally accepted accounting practice within net operating expenditure (depreciation plus actual interest) with the amount required to be met from the authority's (HRA) bottom line.

7.2 The generality of the entries required in relation to the MRA and depreciation in the appropriations section are:

(a) where depreciation for council houses is equal to MRA

no Cr/Dr to the appropriations section of the HRA
Dr Capital financing reserve with amount equal to depreciation
Cr Major repairs reserve with amount equal to MRA
Transfer relevant to depreciation and MRA

(b) where depreciation for council houses is less than MRA

Dr Appropriations section of HRA with amount equal to MRA minus depreciation for council houses
Dr Capital financing reserve with amount equal to depreciation
Cr Major repairs reserve with amount equal to MRA
Transfer relevant to depreciation and MRA

(c) where depreciation for council houses is greater than MRA or depreciation is charged on other HRA assets

either – if the consultation by the DETR results in the additional depreciation charge hitting the bottom line

no Cr/Dr to the appropriations section of the HRA
Dr Capital financing reserve with amount equal to depreciation
Cr Major repairs reserve with amount equal to depreciation
Transfer relevant to depreciation and MRA

or – if the consultation by the DETR results in the additional depreciation charge not hitting the bottom line

Cr Appropriations section of the HRA with amount equal to depreciation minus MRA
Dr Capital financing reserve with amount equal to depreciation
Cr Major repairs reserve with amount equal to MRA
Transfer relevant to depreciation and MRA

Plus in all cases:

Dr Net cost of services with depreciation (as part of capital charges)

Cr Net fixed assets

Write down fixed assets for depreciation.

The following journal entry is also relevant:

Dr Cash

Cr Net cost of services

Receipt of MRA within housing subsidy (NB will be part of housing subsidy entry for actual running)

- 7.3 When capital expenditure is financed through the major repairs reserve, the entries are

Dr Major repairs reserve

Cr Capital financing reserve

To finance capital expenditure from the major repairs reserve

Dr Net fixed assets (council houses)

Cr Cash

Capital expenditure on council houses.

- 7.4 Note in particular (see paragraph 7.2) that no appropriation to/from the appropriation section of the HRA is necessary where MRA equals depreciation charged – the only transfer would be between the capital financing reserve and the major repairs reserve to “piggy bank” the MRA cash in the major repairs reserve until it is actually used, when the amount used is transferred back into the capital finance reserve (see paragraph 7.3).

<<Download Exemplification Appendix (135k)>>