UNISON

Open College

BLOCK HFFS.102

CONCEPTS IN HOUSING FINANCE

Preface

Elsewhere in this Unit we examine the financial arrangements which permit dwellings of all types to be built, repaired, improved, sold and managed. These financial arrangements are largely specific to *particular tenures*, and depend also on whether it is the *provider* or the *consumer* who seeks the finance.

However, the basic terms which are used to describe and define financial arrangements are universally applicable to all different systems of housing finance. There are a number of key *financial* concepts, and these terms underpin any explanation of financing arrangements for all tenures. It is with these financial concepts that we will be concerned in this Block.

Outcomes

When you have completed this Block, you will be able to:

- distinguish between income and expenditure, and revenue and capital items;
- describe the role of accounts, budget and audit; and
- identify sources of internal and external finance.

Contents

A. Budgets and Budgeting

We will begin our examination of budgets and budgeting with two terms with which, from personal experience, you are doubtless already familiar.

1. Income and Expenditure

In general terms, income is money coming in, whereas expenditure is money going out. Let's start our examination of financial terms by looking first at your own finances: what are the main types of income and expenditure for you?

Activity 1

List all of your sources of income below:

Now think about the major things that you spend money on, and try to group these different types of expenditure under category headings (e.g. entertainment, travel) below:

Time allocation: 10 minutes

You will doubtless have discovered that you have many more types of expenditure than income!

Your most likely main type of income is your **salary** (or wage), received from your employer in return for your work. You may, however, have other sorts of income; perhaps you have savings, on which **interest** is paid by the financial institution in which you keep it. Or you may have a **bank loan**, which has provided you with extra spending power. You may have income from lodgers. You may receive **gifts** of money – for example, for birthdays or Christmas. You may even be paid for additional work that you do; for example, you might baby-sit in return for payment.

We have already mentioned two possible types of expenditure: **entertainment and travel**. If you still live at home, you may be paying a sum for **board and lodgings**; or, if you have your own accommodation, you will have to find money for **rent** or **mortgage** payments, as well as for **food**. You will also have **regular bills**, for electricity, gas, water, telephone etc. **Clothing** may be a major source of expenditure. And you may have a loan, so that regular **repayments** are needed.

Housing organisations are in essentially the same situation as yourself: they, too, have various sources of income as well as different types of expenditure. We want you now to try to identify some of these, for your own organisation: if you don't know, find out from colleagues at work.

Activity 2

List the main sorts of income for your organisation: where does the money come from?

List the major types of expenditure which your organisation has: what is the income spent on?

Time allocation: 10 minutes

The types of income and expenditure which you were able to identify will depend very much on the type of housing organisation in which you work. This means that the list compiled by one student may look very different from that compiled by another, and yet both may be correct. Bear this in mind when you compare your list with the very broad suggestions which we make here.

1.1 Types of income

- **Rent receipts** will be a major source for those who let houses to tenants.
- For a building society or bank, **repayments** on loans which have been made will be important.
- **Fees** may be paid to the organisation for their services (e.g. for managing property lets, or selling houses).
- There may be **grants**, received from public or private sources.
- The organisation will almost certainly have **borrowed** money, to pay for housing provision (if it is engaged in this).
- It may also have **savings** put aside from past years' surpluses, which it can use to spend.
- It may have sold property or other items, so that it has receipts **from sales**.

1.2 Types of expenditure

Expenditure will also depend to some extent on the nature of the organisation.

- A major item will be **salaries and wages** for employees.
- A housing provider will have to spend on **housing provision** – whether on new construction, repairs and maintenance, land, infrastructure, etc.
- There may also be a range of **professional fees** to pay to consultants, solicitors, etc.
- If they have borrowed money, there will be **loan repayments** to the lenders.
- There is likely to be spending on **advertising**, **stationery**, **office equipment**, and items such as **cars**, **vans**, and **petrol**.

We have now identified some general types of income and expenditure for different types of organisation. However, as we have seen, these will differ between organisations. Let's now see how we may classify these very different types in a way which is universally applicable to all housing organisations.

2. Classifying Income and Expenditure

Capital and Revenue

The approach which is adopted by accountants is to identify whether the income is from **capital** sources, or from **revenue sources**. Similarly, they classify expenditure according to whether it was spent on **capital** items or **revenue** items. Let's examine this distinction.

CAPITAL items can be defined as **fixed assets**: in other words, items which remain within the organisation relatively permanently. In the context of a housing provider, fixed assets are largely items which increase the supply, or improve the quality of the housing provided, such as new construction work.

For a private company, most of the capital invested in the company's assets will have been provided by the owner(s) or shareholders. However, some assets will have been purchased by borrowing money. These loans are called **liabilities**, and we shall return to this later.

Capital expenditure is, therefore, spending on fixed assets. **Capital receipts** are income received from the sale of capital items, whether currently or in the past. (Note that the term "receipts" is generally used in preference to "income" when it is concerned with capital).

REVENUE is concerned with **consumables**, or **non-fixed assets**. **Revenue expenditure** is spending on items which are quickly used up, often called **expenses**. These are the costs of **running** the business, and include spending on maintaining or repairing dwellings (as opposed to increasing their value by improvement), or on day-to-day management - such as wages, stationery, petrol costs, etc.

Revenue income is income received from the activity of trading or letting, so would comprise rents or charges made, interest received from assets (e.g. held in a bank account, or loaned out), and grants and subsidies received from public or private sources for management purposes (but not grants to purchase assets).

For most housing providers, the distinction between capital and revenue is probably most easily conceived as the difference between finance for provision, and finance for management purposes.

Activity 3

See if you can classify the following items according to whether they are INCOME or EXPENDITURE, and CAPITAL or REVENUE.

Ask yourself:

(i) whether the money is coming in (income) or going out (expenditure), and

(ii) whether it involves a fixed, long lasting asset (capital) or day-to-day, current items (revenue).

Costs of building a new housing estate

Salaries for staff

Interest payments made to a lender

Interest payments received from a borrower

Essential repairs to a property

Rents collected

Printing costs for a new brochure

Sales receipts from the sale of promotional mugs and pens

Purchase of new computer equipment

Sale of a van

Enter each item in the correct square in the matrix.

	INCOME/RECEIPTS	EXPENDITURE
CAPITAL		
REVENUE		

Time allocation: 5 minutes

Now, let's see how we would classify these items:

Capital receipts

- sales receipts from the sale of a property
- sale of a van

Capital expenditure

- costs of building a new housing estate
- purchase of new computer equipment

Revenue income

- interest payments received from a borrower
- rents collected
- receipts from the sale of promotional mugs and pens

Revenue expenditure

- salaries for staff
- interest payments made to a lender
- essential repairs to a property
- printing costs for a new brochure

Did you find it difficult always to make distinctions between capital and revenue? The items listed above were relatively straightforward, but it can be difficult to decide which an item is. Some capital expenditure may be financed from revenue income – for example, rent income may pay some of the costs of refurbishment. Furthermore, most capital expenditure has implications for future revenue expenditure – so, if we build a new housing estate (capital expenditure), we will have to find funds for its repair and maintenance in future (revenue expenditure). This is further complicated by the fact that the distinction is sometimes blurred by the organisations themselves, so that what counts as capital or revenue may depend, for example, on what funds are available at the time, and so which "heading" is appropriate.

At this stage, don't worry too much about precise distinctions: we'll be examining these in much greater detail in later Blocks of the module. We will now examine what is meant by the **accounts** of housing organisations.

3. Accounts

Accounts are records of all financial transactions made by the organisation: in other words, records of expenditure and income.

Let's return to your income and expenditure. You doubtless keep some sort of record of your financial transactions – even if only in the form of a rough calculation on the back of an envelope, to check whether you have enough funds for a purchase.

You may have a bank or building society account, in which case you will receive **statements of account**, which set out a record of your transactions. You will (or should!) check that these records match with your own, in case there has been an error. These are *your* accounts.

In the same way, a housing organisation needs to keep records of its financial transactions. Since there will be a much larger volume of transactions than in the case of your *personal accounts*, these accounts will be rather lengthier.

However, the reasons why organisations need to keep accounts are likely to be rather more complex than yours. Before you read on, we'd like you to think about what these reasons might be.

Activity 4

Try to identify at least ***four*** *reasons why it is essential that housing organisations must keep detailed and accurate accounts.*

(Think about their sources of income, and who they are accountable to.)

Note your ideas here:

Time allocation: 10 minutes

3.1 Reasons for keeping accounts

These are our suggestions, though you may well have identified other, equally valid reasons:

(a) They provide a record of expenditure, so that the organisation knows how it has spent its money; over time, it should be able to identify high cost aspects, where savings might be made.

(b) They are a record of income, so that we know who has paid what (particularly important, if we are not to pursue people for debts which have been paid!).

(c) They make it more difficult for people to steal from the organisation, since every transaction must be recorded - and unrecorded ones should show up (for example, by there being income which isn't accounted for in the expenditure records).

(d) They enable the organisation to check whether it is profitable, or, (in the case of a non-profit making organisation), at least covering its costs.

(e) They enable the organisation to identify what it owes as well as what it owns.

(f) They help to ensure that the organisation is accountable for its actions. All managers of organisations are accountable to somebody, whether shareholders, council tax payers and councillors, or the management committee, and they need to check how well the organisation is being managed.

(g) They provide valuable information to assist planning future expenditure – i.e. they are useful for BUDGET preparation (we'll consider budgets next).

So, all housing organisations need to keep accounts. Some have, by law, to publish information from their accounts so that they can be examined by anyone. This requirement applies to local authorities and housing associations as well as to all **Public Limited Companies** (plcs), who sell shares in their company to the public.

Generally, the **Inland Revenue** will also wish to examine the accounts, to determine whether the organisation is liable to pay tax on earnings. This does not apply to local authorities or charitable housing associations.

Since the financial records kept by the organisation will be very lengthy, they are summarised on an annual basis, as the **Annual**, or **Final Accounts**.

3.2 Annual Accounts

These are the summarised records for a defined financial year. Different organisations may have different financial years – e.g. 1 April 2004 to 31 March 2005, or 1 January 2004 to 31 December 2005.

The annual accounts show the **income** and **expenditure** for the year. This will be split into **capital** items and **revenue** items.

A **balance sheet** may summarise the **assets** and **liabilities** of the organisation. You have already met these terms when we said that assets are fixed items purchased with capital, but they may also be purchased using borrowed money. These loans are **liabilities** to the organisation. Assets include capital items such as land and buildings. Another important asset may be loans which the organisation has made to others, and which will be repaid.

Liabilities are anything which the organisation owes to others. These will include money borrowed (usually long term) for capital expenditure, as we saw above, as well as various short term debts, such as money owed to a supplier for the period between receiving the goods and paying the invoice (bill).

Although all organisations produce accounts, their style and contents may be very different. Their exact form will depend, to some extent, on the particular needs of the organisation. Organisations which exist to make a profit, for example, will need to produce statements of this, in the form of a **Profit and Loss Account.**

4. Budgets

Let's now return to a term which was introduced earlier, a **budget**. We said that accounts are records of **past** financial transactions. They are **historic**. They therefore provide information about past income and expenditure, which is useful when planning **future** spending. The planning of future spending is called **budgeting**.

To prepare a budget, the organisation needs to estimate, as accurately as possible, the income it will receive over the coming year. It then identifies how this money will be allocated to different uses. You can see, therefore, that records of past financial transactions can be useful in identifying likely future costs; they provide guidance for estimates. The organisation may, however, decide that the balance of past expenditure was wrong, and may wish to allocate funds differently in the coming year. So, although the budget can be informed by the accounts, it will not necessarily follow the same patterns of income and expenditure.

A very simple budget for a private sector landlord might look like this:

Income from rent	£11,000
- less profits	£ 3,000
	£ 8,000
Expenditure	
- repairs	£ 4,000
- repainting	£ 2,800
- advertising	£ 200
- tax liability	£ 1,000
	£ 8,000

This enables the landlord to see just how much he can spend on maintaining the properties, and he will have to try to keep within his budget or his profits will soon disappear!

This year's budget may well be different from last year's, because he may be anticipating higher income (due to rising rents), or perhaps greater expenditure (e.g. the need to repaint).

It is usual when setting a budget to find more claims on resources than the income available. There may be many competing needs each seeming to require more expenditure than is available!

In this situation, what is needed is some form of **prioritisation** of the different claims on finances. Some categories of expenditure are more easily adjusted than others. In housing organisations, the least flexible form of expenditure is paying back loans taken out to pay for past capital spending. The next least flexible item is expenditure on salaries and wages. If this item is to be reduced, then it means that staff have to be made redundant, and few employers would take this option lightly. Office expenses, such as telephone bills, stationery, postage, photocopying, etc., are also difficult to cut significantly. So, in a climate of spending restraint, just a few of the (more flexible) types of expenditure will often bear most of the reductions.

For a housing provider, the more easily adjusted items might include spending on **repairs and maintenance**. However, if the budget for repairs and maintenance is cut, there will have to be a further prioritisation *within* this category, to determine which claims are most urgent. Clearly, it is not sensible to delay repairs which will result in much greater longer term costs, but other items may be more easily delayed. For example, a leaking roof – which, because it allows water penetration, could cause significant damage to the property – would have to take precedence over a repair concerned mainly with convenience, such as a stiff door. You will be looking, in detail, at issues such as this in the Housing Development Module.

4.1 Preparing the budget

Traditionally, many housing organisations have used very basic forms of accounts and, providing overall costs have remained within budget, have not concerned themselves too much with what happens to expenditure within budget sub-heads. As a result, their understanding about what services cost and whether there are elements of the service which are wrongly priced, is poor. Typically, organisations with this kind of budget have used simple, 'incremental' techniques for establishing their annual revenue budget: if overall costs need to rise by 1%, every budget heading is increased by 1%, regardless of whether in preceding years they have underspent, spent to 'target', or overspent.

As decentralisation gathered momentum during the 1980s, many organisations realised that they needed better budgetary information and, in particular, needed to be able to separate out costs for different office establishments. The introduction of 'Cost Centre Accounting' became more commonplace.

Cost Centre Accounting

Cost Centre Accounting involves the organisation in using information about what various 'Cost Centres' earn in the way of income and/or what they spend. The 'Centre' can be subject headings - homelessness, sheltered schemes, tenant participation, etc., and/or geographical. A small-medium sized authority with 8 area offices, a warden centre, 15 sheltered housing schemes and a headquarters establishment split into 4 teams - technical, housing needs and resources, finance (including rent accounting), and administration and support services - might organise its budget into 27 cost centre headings, with each having a similar range of sub-headings. An example is set out below.

Area Office 1

Establishment Costs

Office rental
Rates
Water charges
Electricity
Gas
Cleaning
Telephones
Photocopying
Computers
Stationery
Printing
Office furniture
Office equipment
etc., etc.

Staffing costs

Salaries
National Insurance
Sick pay
Recruitment
Training
etc., etc.

Other expenditure

Meeting room hire
Tenant group grants
Hospitality etc., etc.

Within each cost centre budget, be it geographical (i.e. an area office) or operational (e.g. maintenance or management), a further distinction may be made between **Direct** and **Indirect** expenditure.

Direct expenditure is any expenditure relating directly to and only to that cost centre, e.g. a heating bill for premises used only by the housing organisation concerned or the salary of a member of staff carrying out duties related only to that area of operations.

Indirect expenditure relates to payments apportioned to that cost centre from the organisation's central expenditure, e.g. the Chief Executive or Director's salary may be apportioned between cost centres on a proportional basis.

With the advent of the Best Value regime, all housing organisations are under pressure to be able to provide accurate figures about how much specific parts of the service cost. This has been a spur to adopt improved budgetary procedures. Some local authority housing staff have seized the opportunity to seek explanation from other council departments of charges imposed for their services, and pressed for the introduction of client controlled **Service Level Agreements (SLAs)**.

Cost Centre Accounting, however, only provides information about expenditure patterns across operational areas: it does nothing to ensure that effective budgetary control is introduced. So Cost Centre Accounting has often been followed by the introduction of Commitment Accounting.

Commitment Accounting

In simple terms, this can be likened to the principles of running a cheque account, where the value of the cheque is deducted from the account at the point the cheque is issued, not when it is encashed by the recipient. 'Obvious', you may say if you are a responsible user of your cheque book - but think of how many people run their own finances without doing so - how often have you stood behind somebody in a bank and heard them asking the cashier what their balance is?!

However, even with Cost Centre Accounting and the use of Commitment Accounting techniques, many organisations persisted with incremental budgeting as the basis for setting the annual budget. Continued pressure to make savings on costs, and particularly those brought about by CCT, has finally encouraged the most reticent of organisations to move to 'Zero Based budgeting.'

Zero Based Budgeting

In these circumstances, the annual budgetary process becomes rather more complex: it is no longer a simple case of increasing overall budget levels to accommodate growth plus any underlying level of inflation and then increasing rents accordingly. First of all, there needs to be a thorough scrutiny of the total budget in terms of organisational objectives, and this then needs to be regularly reviewed. This will involve performance on each item of the budget being reviewed: where there is underspend - and this is considered to be a genuine reflection of the need/demand for that service/expenditure - then the base budget will be reduced accordingly. Similarly, where there is overspend, consideration must be given to:

(a) means of reducing expenditure, so that the original budget can be retained; or

(b) if it is considered unavoidable that spend of this level continues, identifying either

- corresponding savings elsewhere; or
- increased income.

Most organisations now have a formal process of half yearly review of budgetary performance, which is followed by the commencement of budgetary estimates for the following year. In the case of local authorities, the limitations for all council budgets will often be set corporately by the Leader and Cabinet and the housing department will have to work within whatever constraints they are set.

Officers will normally prepare a budget report for the relevant Committee/Board at the relevant time (usually around November), in which they will:

- identify savings;
- suggest areas of growth;
- comment on revised usage of services; and
- review assumptions.

Consideration will also be given at this stage to current guidance on rent increases.

4.2 Capital budgets

Capital budgets or programmes are set in much the same way as revenue budgets though, because there is a wide variety of potential sources of income, some of which has to be ‘won’ in a competitive bidding situation and some of which is only available for specific purposes, they are often more complex. What an organisation can afford to do in terms of capital works (largely building and/or refurbishing its stock) will depend on what resources it can assemble.

4.2.1 Housing need

Decisions to build new houses need to be based on the knowledge that the completed homes can be let. This requires that the provider has a good understanding of housing need or demand. It is no good building 1 bedroom flats if the need is for 4 bedroomed houses. And it is no good building them in an area of a town or village where there is already sufficient housing or where it is remote from schools, employment, transport and shopping facilities.

4.2.2 Stock condition

Similarly, when it comes to investing in the existing stock, a provider needs to know that its money is being used effectively. This will, in part, involve ensuring that it is dealing with the most serious problems, i.e. problems that involve the health and safety of occupants and that affect lettability. Thus, asbestos removal, structural repairs and electrical rewiring, etc. will take precedence over desirable but non-essential work such as heating improvements, provision of porches and environmental improvement work. Many providers now undertake regular stock condition surveys to help to inform these decisions.

4.2.3 Financial appraisal

For some stock problems, there may be a number of different solutions. For example, an unpopular block of flats with many vacancies could be demolished and rebuilt, or remodelled to provide a different type of accommodation. In such circumstances, most organisations would evaluate these options by comparing the likely costs of each with the anticipated income it would produce over a 15-25 year period. This process is known as financial appraisal.

4.2.4 The bidding process

Once an organisation has established its needs for investment in its stock and made decisions about its priorities, it needs to seek appropriate funding. We shall examine sources of finance shortly and the processes of bidding for some of these later: what it is important to recognise at this stage is that this forms an integral part of the budgeting process. Thus, while the most urgent problems will be given top priority for any funding which is available for use at the organisation's discretion, there may be lower priority problems which 'leapfrog' their way into a particular year's capital programme because they fit the criteria for a particular source of funding while higher priority projects do not.

4.3 Monitoring budgets

Once the budget is set, spending must be constantly monitored, to ensure that expenditure remains *within budget*. However, budgets are not cast in stone. Despite *tight budgetary control* (i.e. very careful monitoring and limiting), unexpected and unavoidable expenses may arise. This may mean that the budget has to be revised, and planned expenditure reallocated.

Over the next few weeks, try to monitor your budget to see whether you are exercising sufficient budgetary control. You may then find that you need to adjust your budget to accommodate any differences between actual and planned expenditure.

The process of monitoring can be assisted by devolution of budgets, either on a functional or geographic basis. The key point about devolution of budgets is to make sure that staff are properly trained and understand the accounting conventions which must be followed.

Self Test 1

1. *What is the difference between CAPITAL items of income and expenditure, and REVENUE items? Give some examples.*

2. *Why keep accounts?*

3. *Describe briefly how budgets are prepared.*

4. *What is meant by financial appraisal?*

5. *Why is budget monitoring important?*

Now turn to the Answers at the end of the Block.

Summary

1. *Capital expenditure* is spending on fixed assets, such as new houses or offices.
2. Fixed assets may be paid for from loans. These are termed *liabilities.*
3. Spending on management, administration, maintenance and repair is *revenue expenditure.*
4. *Capital receipts* come from the sale of capital assets – e.g. Right to Buy sales, or the sale of repossessed homes - or from *grants* paid toward spending on assets.
5. *Revenue income* comes from current earnings, whether from the letting of homes (rents), from interest paid on money loaned out, or from subsidies (grants) paid towards day-to-day costs.
6. All housing organisations must keep accounts.
7. Accounts are records of all financial transactions made by the organisation.
8. These will record all items of expenditure and income, whether capital or revenue.
9. This ensures that the organisation has full knowledge of its finances, which is essential if it is to make the most efficient use of its resources.
10. The financial records are summarised annually, in the Annual Accounts.
11. The exact form of these accounts is different for different types of organisation.

B. Sources of Finance

In the last section, in Activity 2, you identified the main types of income for your organisation. We then went on to distinguish between income from capital and income from revenue sources.

Now we need to make another important distinction about the money – or *finance* – available for the organisation (or individual) to use.

This distinguishes between money generated *within* the organisation itself, and money which comes from *outside* the organisation. These are called **internal** sources of finance and **external** sources.

Be careful not to confuse these terms with *capital* and *revenue*, which we have already examined.

- Remember that the capital/revenue distinction is concerned with **time scale** – whether the assets are **fixed** (long lasting) or not, or whether the income is generated from trading/ letting (immediate activities) or not.
- In contrast, the classifications **internal** and **external** are concerned with *who or what is supplying the finance* – whether the organisation itself, or others outside the organisation.

In practice, as we shall see, revenue items are more likely to be financed from internal sources than are capital items, which are often financed externally.

Activity 5

Can you think of any reasons why capital items are more likely to be financed externally? Think about the nature of most capital items, compared to revenue items. Go through some examples of each, in your mind, and think about what distinguishes them, in financial terms.

Time allocation: 5 minutes

Hopefully, you have identified that capital assets tend to be very expensive compared to revenue items. It takes a long time for anyone – an individual or an organisation – to save up for a very expensive capital item. They are likely, in these circumstances, to borrow the finance – from an external source. Revenue items, being cheaper, can be more easily afforded from internal sources.

We need to make one further distinction, – between ***sources for customers*** (i.e. individual consumers of housing services) and ***sources for organisations***. We'll examine some examples of these next.

1. Internal Sources of Finance

1.1 For customers

You may already have identified some internal sources of finance when you listed your sources of income in Activity 5. Here are some possible sources:

- income received (from the sale of your services to an employer, or by selling them direct to the customer, via self-employment);
- savings (past unspent income) – as when you save up for something, such as a holiday;
- interest earned from savings, in bank accounts, etc.

1.2 For housing organisations

As you already know, housing organisations potentially have a larger range of internal sources, depending on the nature of the organisation. We indicate below when the source identified is likely to be confined to some housing organisations only.

- Rent income (housing providers).
- Mortgage or loan repayments from customers (mortgage lenders).
- Trading profits (non-charitable organisations) – the money remaining when all expenses have been paid.
- Savings (from past income or profits).
- Interest paid on savings (in bank accounts, etc.).
- Charges paid by customers for services (e.g. administration fees).
- Income from the sale of assets (for example, council house sales, or Housing Association build-for-sale housing).

You will see that some of these internal sources may be quite substantial. For example, local authorities have received very large sums from their Right to Buy sales, although government has strictly controlled how and when this money may be spent. The profits of some builders and other private organisations operating in housing markets can also be quite substantial – though, in a recession, profits may turn into quite dramatic losses. If the firm is to survive, it will need to fund these losses from past profits (which have been *retained* or saved), or from external sources. No firm can, however, sustain a loss-making situation for very long.

Let's move on, then, to identify some examples of external sources of finance.

2. External Sources of Finance

2.1 For customers

Before we consider the external sources of finance for housing customers, we need first to distinguish between those who rent their accommodation – tenants – and those who purchase their accommodation for occupation – owner occupiers. Each has different potential sources of external finance.

(a) For tenants

Tenants, of both public and private sector landlords, may need help to pay for their housing costs.

(i) ***Housing Benefit*** is the main support available to pay housing costs. It is *means tested*, so tenants' incomes must be below certain levels – known as the *applicable amount* – to get all of the rent paid. If incomes rise above the applicable amount, housing benefit is reduced.

Since the 1988 Housing Act, all new private sector tenancies are deregulated. Landlords are free to charge "market rents." However, if they know all costs will be paid by housing benefit, they may be tempted to charge rents which are even higher. Tenants may also take accommodation of a higher standard than they need (e.g. larger, or more luxurious). For this reason, Rent Officers now have to determine what market rent levels *ought* to be, and housing benefit is only paid up to this level. The rules governing housing benefit are discussed in greater detail later in the module.

(ii) ***Council Tax Benefit***, like housing benefit, is means tested. There is also a reduction in the tax for people who can prove that they are living on their own.

(b) For owner occupiers

Housing is expensive, so few people can afford to purchase a home from their internal sources of finance. External sources for owner occupiers take two main forms: loans, to help pay the capital costs, and subsidies from the public sector. We shall examine each of these next.

(i) Loans for house purchase

Most home owners purchase with the help of a loan. Usually, this will be a **mortgage**, which means that the loan is secured against the house.

Banks and Building Societies are the major sources of loans for house purchase, though insurance companies also offer mortgages. Usually, the amount of the loan is limited by two factors:

- *The value of the property*

  Seldom is a loan made to cover 100% of the cost of the purchase. It is usually expected that the buyer will pay some of the cost from their own, internal sources. So, buyers may have to *save* to get this *deposit*. The remainder is borrowed, to be repaid over a long period of time – commonly, 25 years.

  Generally the maximum loan offered is for 80% of the value of the property. Higher percentages may be available, but only if the borrower pays an *insurance premium*, *to cover the additional amount* borrowed (above the normal maximum). This is intended to provide the lender with some protection against falling property values, though it is of little value when there are large falls, such as occurred in the late 1980s.

- *The incomes of the applicant(s)*

  Whatever the value of the property, the lender wants to be sure that the borrower can afford to make the necessary monthly repayments. Failure to keep up these payments may result in the lender obtaining a **possession order**, and the owner becoming homeless. So, there is usually a limit to the size of the loan – commonly, up to three times annual income.

Mortgages are examined in detail in Block HFFS.105.

(ii) Subsidies to owner occupiers from the public sector

These take three different forms: benefit payments (like those available to tenants), help with maintenance costs, and tax concessions. A tax concession means an exemption from paying a tax. Thus, it is not strictly a subsidy, but rather an exemption from payment. However, the result is the same as a subsidy in that it increases the income which the occupant has available to spend. We shall briefly examine these three forms next.

Benefits

Owner occupiers are eligible for two types of benefit, which relate directly to housing costs.

- *Council Tax Benefit* is available to low income owner occupiers.
- There are also some provisions within the Income Support scheme (the general social security benefit which acts as a safety net for the very lowest paid) to help home owners, including provision for the Department for Work and Pensions to pay mortgage interest directly to the lender. This is examined in detail in Block HFFS.107.

Maintenance

Home owners can also get help with repair costs. In England and Wales this is on a means tested basis; in Scotland it is not. These *Home Improvement Grants* are examined later in Block HFFS.108.

Tax concessions

Owner occupiers are eligible for a number of different tax concessions. Taken together, these represent a major subsidy to housing costs.

(a) No tax on imputed rents

Owners of property pay income tax on any rent that they receive. In fact, income earned by an individual from any asset is taxable. However, although an owner occupied house is clearly an asset (with lasting value), no tax is charged on the income from it.

You might say that this is because there is no income from it, since it is not rented out. But owners are, in reality, taking this income *in kind*. They are enjoying the services of the house, just as a tenant does, but no rent is paid. They choose to live there, taking the services of the house, *rather than* letting it to receive income. Compare this to the services of a company car. This is income in *kind*, but tax is charged on the value of the service to the driver. There is no obvious reason why the services obtained by owner occupiers from their homes should not be taxed in the same way. Indeed, it used to be the case, and was known as *Schedule A income tax*. The rental value was imputed, or estimated. This was abolished in 1963.

(b) Capital Gains Tax exemption

Capital Gains tax is payable on the increase in the real value of an asset, when it is sold. So, if I own, say, shares in a company, and I sell them after a few years for a much higher price, I will be taxed on the gain in value (after allowing for inflation). Owner occupiers are exempt from this tax on house sales but only on their main residence.

In addition, those who inherit housing from, for example, their parents, do not pay inheritance tax on the first £263,000, and therefore the capital (and the capital gains), can be transferred from one generation to the next. Partners of owner occupiers who die, can inherit the main residence without paying any inheritance tax, and the value of the property does not count against the value of the estate at all.

Taken together, then, you can see that owner occupiers receive substantial assistance from the State in the form of various tax exemptions and reliefs. This means that, although owner occupied housing is an asset, it is treated, for tax purposes, very favourably in comparison to other sorts of assets. People will be encouraged, by this favourable treatment, to invest in owner occupied housing, in preference to other sorts of investment. It is not surprising, then, that we have witnessed such a large expansion of the owner occupied sector over the last 50 years or so.

We will turn now to examining external finance for housing organisations.

2.2 External finance for housing organisations

As we have already discovered, many organisations' spending on **capital items** will need to be financed from external sources, because capital assets tend to be very expensive. In the case of housing **providers**, the main type of capital expenditure is, of course, building, or buying, the houses.

To a large extent, the sources of finance for housing organisations depend on the type of organisation. There are major differences between **private** and **public sector** organisations. Examples of their different external sources are identified next.

(a) Local authorities

Since 1979, local authorities have had the obligation to survey local housing needs, and produce a **Local Housing Strategy** to deal with these needs. Until April 2004, they would use this as a basis for preparing a 'bid' to government for permission to borrow money to carry out the plan, usually called a **Housing Investment Programme** or HIP in England and Scotland or a **Housing Strategy and Operational Plan** (HSOP) in Wales. The ODPM/ Scottish Office would then grant **Credit Approvals** – permission to borrow – usually below the HIP bid. Since April 2004 local authorities have had more freedom to borrow money to finance their housing capital programmes, under a new system called 'prudential borrowing'. You will be examining this process in some detail in Block HFFS.103 dealing with local authority finances.

But the question remains, who *lends* money to local authorities? The sources are many, ranging from financial institutions (such as insurance companies), other companies, and individuals. Most of the money is borrowed long term – up to 60 years – so that the financial situation is fairly stable. The debt itself, in the form of **Bonds**, can be sold to new owners, so the lenders will change over time. Interest is paid annually, and the debt redeemed (repaid) only at the end of its full term.

The loans are not simply for capital expenditure on housing, but rather are obtained to cover all types of local authority capital spending. The amount required by housing is then transferred from the central **Loans Fund**, which controls overall borrowing.

In addition to borrowing, local authorities receive some capital expenditure grants from central government, which do not have to be repaid. These funds are examined later in Block HFFS.103.

(b) Housing associations

(i) Government grant

Housing associations, which are registered with the Housing Corporation, or the Scottish or Welsh equivalents, Communities Scotland and the Department of Social Justice and Regeneration, are eligible for a major grant from central government, called **Social Housing Grant**, or SHG. The associations must obtain approval for their project plans, and SHG is awarded at predetermined proportions of total cost. This process is examined in detail in Block HFFS.104 of this module.

(ii) Mixed funding

In addition, many housing associations have to raise finance from private sources. This is a process called *mixed funding* – i.e. a mix of SHG and private funds. Sources may be wide-ranging, but banks and building societies, in particular, are often a major source of loans.

(iii) Local authority funding

A less obvious source of finance is local authorities. They can no longer offer grants or loans to housing associations, but can subsidise new housing by selling land at *below market price*, or by transferring stock to an association for rehabilitation. This means, for the association, that it can expand its stock at a cost lower than normal new build. For the local authority, it means that social housing expands, or run-down stock is refurbished, much sooner than would be possible under their current financial constraints.

(c) Private landlords

Unlike housing associations, private landlords do not have the benefit of a special institution (like the Housing Corporation) to help to finance provision. The situation for individuals who are landlords is rather different, however, from the situation for companies.

(i) Individual landlords

Individual landlords depend heavily on their own *internal* sources of finance, and may find it difficult to obtain external funding. This is partly because, historically, returns on investments in residential property to let were poor, due to rent controls. Since the **1988 Housing Act**, and the new **assured tenancies**, private landlords have been free to charge **market rents** to new tenants. This should result in better returns from the higher rent levels. However, even if the landlord is able to borrow funds from a bank, interest charges will be relatively high. They are, however, able to deduct any expenses incurred, such as the cost of repairs, from their profits, before their liability to pay income tax (on the profits) is assessed.

(ii) Companies as landlords

Large firms, such as property development companies, may be **public limited companies**. If so, they will have 'Plc' after their names. This means that they may be able to sell additional **shares** in the company, thus acquiring more owners. These new shares are **issued** through the **Stock Exchange**, so that anyone can purchase them. This is known as **equity** finance. The company can then spend the extra finance raised on buying new properties.

> Alternatively, the Plc may choose to raise loans through the Stock Exchange. They are called **debentures**, and are sold in much the same way as shares. Like shares, they too can be traded, or sold, by their owners. However, unlike shares, they do not confer a share in the ownership of the company. They are simply loans.

The **redemption date** – the date on which the capital sum of the loan is repayable – will vary, depending on how long the firm wants the money for. Interest on the loan is usually paid annually.

If the firm is a **private limited company** (Ltd), the owners may agree to sell further shares in the company to a person or institution of their choice. Unlike the Plc, a private limited company cannot sell shares to the general public. Similarly, they too can sell "debt" to raise loan finance.

In recent years, various governments have introduced tax incentives aimed to stimulate increased activity in the private rented sector.

From 1988 - 1993, the Business Expansion Scheme allowed individuals investing in companies which let houses on assured tenancies to benefit from income tax relief on investments up to £40,000 p.a. Furthermore, so long as the shares in such a company were held for five years, the individual was also exempt from Capital Gains Tax. These incentives ended in 1993 so that, by 1998, no further benefits were available.

In 1996, the Conservative government of the day made provision in the Finance Act of that year for Housing Investment Trusts. These were investment trusts that could operate under special rules and obtain two tax advantages - a lower rate of Corporation Tax and exemption form Capital Gains Tax. These have not so far played a significant role, although the idea still features in current policy debates.

Self Test 2

1. *List some of the possible internal sources of income for a housing organisation.*

2. *What are the main sources of external finance, for different types of housing provider?*

Now turn to the Answers at the end of the Block.

Summary

1. Budgeting involves the current allocation of resources. Income and expenditure must balance, so this requires prioritisation of projects.
2. Spending must be monitored to keep within budget, and budgets may need to be revised
3. The main sources of housing finance for customers are:
   - for tenants: housing benefit and council tax benefit.
   - for owner occupiers: private sector loans, council tax benefit, income support mortgage benefit, improvement grant and tax concessions.
4. The main sources of finance for housing organisations are:

   (a) internal sources, rent income, loan repayments, profits, savings, interest, fees, and the sale of assets.

   (b) external sources: financial institutions companies, individuals, government grant.

   In addition, local authorities may subsidise housing associations by selling them building land at below market price.

   (c) There are no special financial arrangements to help individual landlords. They depend heavily on internal sources and bank loans.

   (d) Company landlords may raise equity finance (shares) or long term loans (debentures). BES companies receive tax reliefs.

C. Audit

1. Introduction

An audit is proof that the financial records provided by an organisation are true. This is, of course, important for it enables others, outside the organisation, to make judgements about the way the financial affairs of the organisation are being handled.

When complete, the audit of the accounts of an organisation gives them a high degree of 'guaranteed truth'. To ensure this, the work of auditors is regulated by law, and by the professional associations of auditors, who are closely concerned with the education and training, and with the professional standards of those licensed to work as auditors.

Ultimately, the professional bodies have the power to 'strike off' professionals who do not maintain appropriate standards.

In this section, you are going to learn about the principles of auditing and the reasons why the process is important. We will aim to understand:

- the objectives of the audit process;
- the parts of the audit process;
- the significance of the audit process for directors, shareholders, employees and public.

2. Audit in the Private Sector

2.1 The legal requirements

The law requires that all companies and certain other institutions, such as building societies must:

- maintain proper accounting records;
- prepare financial statements;
- have the financial statements audited.

Each of these activities have to be undertaken by the directors of the company or organisation. As well as a legal requirement, it is a responsibility to shareholders, employees and others. The responsibility to shareholders is often seen as the overriding issue, for the directors are the 'trustees' of the money provided by shareholders, and they are expected to inform the shareholders as accurately as possible.

2.2 The audit

The statement

The audit statement or report is normally added to the company records and becomes part of the company accounts. It is made up from a series of legally important phrases and is usually very brief, possibly less than a hundred words. This is particularly so when the auditors are able to make an 'unqualified' audit report – that is, there are no criticisms of the records. This brevity does not mean that the statement should be taken lightly. Much work will have been done by the auditors so that they are in a position to be able to make the brief statement. The audit will have had to have been carried out by highly trained professionals, and at quite a considerable expense to the business.

2.3 Independence

The essential objective of the preparation of a set of accounts of a business is that they are a reflection of the financial state of the organisation.

In the auditing process, the accounts are assessed by independent outsiders, who can then assure others that the accounts presented are a *true and fair* reflection of the financial position of the organisation.

The simplest way of understanding the role of the audit is to recognise that the directors of an organisation are accountable for the business in two ways.

(a) They are accountable to shareholders, who provide the resources which are managed by the directors. This form of accountability is sometimes called stewardship.

(b) They have a duty to those who can claim an interest in the resources, or in the decisions being taken about them. This includes lenders to the organisation, suppliers, customers and employees. It is arguable that this list can be extended to include the State and the local community.

The audit exists because there is a recognition that the directors of a company, or indeed of any organisation, have some degree of conflict of interest in the provision of the accounts. The directors' performance over the year is likely to be judged, by shareholders and others, by the state of the organisation's accounts. The directors might be tempted to present the facts about the company in a light which is favourable to them.

The audit report, because it is provided by independent professionals, to a professionally recognised standard, is regarded as an unbiased and accurate record of the organisation.

2.4 The process

To ensure that the report is full and frank, a number of simple accounting practices have been adopted.

(a) Prudence

There is a policy of **prudence** in audit reporting. An example of this is that auditors take a cautious view of profits and losses, reporting a loss when likely, but only reporting a profit when it has been actually obtained.

(b) Disclosure

The auditors are required to ensure that the organisation makes a statement about all information necessary for others to form a true and fair view of it. This is a particularly difficult area for the auditor, for shareholders of a company are particularly concerned to obtain information about future trading conditions, while the firm will not wish to disclose confidential commercial information about its activities.

(c) Balanced books

Finally, the auditor ensures that there is a matching of expenditures and incomes within each accounting period. Assets and liabilities must balance, as should income and expenditure.

(d) Accuracy and completeness

Auditors have to rely on the accounts provided by the directors of the organisation. The auditors have firstly to ensure that the methods of accounting used are capable of producing the degree of accuracy and completeness required for the audit process.

The directors do not leave this stage to chance: they negotiate with their auditors an appropriate accounts system. The auditor checks that the system has been used, and then undertakes a number of tests to ensure that both accuracy and completeness are being achieved. For example, the auditor will take a sample of sales accounts and check that the information from these has been accurately included in the accounts.

Another method is to make a physical examination of the assets of the organisation, such as the buildings, to ensure that their value has been accurately assessed. In the financial sector, the auditor will inevitably check that a sample of loans which are 'secured' (by a mortgage) are indeed secured by real buildings.

It is not possible for the auditors to check every financial detail in the company accounts, and the possibility of some error and/or fraud must remain. It is unlikely however: if the auditor does find some discrepancy in the directors' accounts, then the auditor will extend the enquiries into the reasons for the error, and check to see whether the error could have been repeated.

2.5 The use of audited accounts

A set of audited accounts has a number of purposes:

- they can be used to judge the managerial effectiveness of the directors;
- they will be used to calculate tax bills (for non-charitable organisations);
- they are used as a basis for assessing the credit worthiness of the organisation;
- they are used by those who wish to buy or sell the shares of a company;
- they assist courts in determining the legality of the organisation's transactions;
- they may be used to determine profit sharing;
- they provide information for customers and suppliers;
- they are referred to in wage negotiations.

Clearly, the wide use to which the accounts are put means that accuracy is important. It is the independent auditor who guarantees, as far as possible, the accuracy of the accounts, and ensures that they can be fully used.

2.6 Management audit

The normal auditing process, while providing a true and fair view of the operation of the company, does not attempt to evaluate the management by comparing it with others. This is quite different from the local authority sector where in recent years the issue of comparable performance has become a major audit activity.

In the private sector, each organisation is different, so direct comparison would be inappropriate and often meaningless. It is the reader of the 'full and frank' accounts who judges the quality of the management.

3. Audit in the Public Sector

3.1 Financial audit

In principle, the audit of the public sector has the same objective as the audit in the private sector. Its objective is to show that the accounts produced by local authorities and other public bodies are a true and fair reflection of the organisations.

The accounts are important to the public, for they are the financial record of the organisation and they show how it has spent taxpayers money.

The accounting and audit practices are similar, except that in the public sector there are strict rules laid down by central government as to how money can be spent. For example, the Housing Revenue Account is “ring fenced” to prevent council tax income being used to subsidise rents. The auditors have to be assured that rules such as these have not been broken.

3.2 Management audit

As we said above, the issue of comparable performance has become a major audit activity in the public sector in recent years. Performance Indicators for a whole variety of activities have been introduced. These must be reported annually, both to specified regulatory bodies and, in some cases, to service users and/or the general public.

This development builds on the foundation of traditional management audit in public sector organisations. In the local authority sector, these duties are undertaken by the Audit Commission and the District Audit Service (the Accounts Commission in Scotland). In the RSL sector, audit used to be the responsibility of the Housing Corporation in England, but since 2003, the Audit Commission has also become involved in inspection. In Scotland and Wales this role is retained by Communities Scotland and the Department for Social Justice and Regeneration.

3.3 The Audit Commission

The Commission’s main responsibility is to appoint auditors to all local authorities and health authorities in England and Wales, and to help them to ensure that they provide their services ‘economically, efficiently and effectively’. Fees from clients comprise the major part of the Commission’s income: no subsidy or grant is made by government towards its activities.

The Commission has two main roles:

- To ensure that local authorities are spending money and reporting their financial situation properly and legally, and have adequate safeguards to avoid fraud and/or corruption. This is otherwise termed “the proper stewardship of public finances”.
- To show authorities how services can be provided as cost-effectively as possible.

The aim behind these is the **improvement of public services**.

This work involves the Commission in:

- the appointment of auditors to audit the accounts of local authorities;
- researching and investigating service provision to identify good practices which improve economy and efficiency and have proved to be effective.

The Labour government elected in 1997 introduced the principle of Best Value, to replace the previous Compulsory Competitive Tendering regime. Best Value is a requirement that local authorities *'deliver the quality of service that people expect at a price they are willing to pay'.* Local authorities are required to:

- *Challenge* the traditional way in which they have provided services;
- *Consult* customers and staff;
- *Compare* their services with others, through benchmarking;
- *Compete* by subjecting some services to external competition.

Performance is measured by the use of Performance Indicators (or PIs). For housing services, the government set up a Housing Inspectorate within the Audit Commission to undertake cyclical inspections of different local authority housing services and report on them, disseminating good practice. The Housing Inspectorate reports form part of the Comprehensive Performance Assessment framework. The Best Value legislation authorises the intervention of the Secretary of State where there are serious failures or weaknesses in an organisation. In Scotland, monitoring Best Value in housing is the responsibility of Communities Scotland and Audit Scotland, and in Wales, the Wales Audit Office.

Activity 6

What advantages and disadvantages do you think might be associated with these performance indicators and the results published? Write your ideas below.

Advantages	***Disadvantages***

Time allocation: 15 minutes

The advantages you might have thought of may include:

- provides information to the public on how their local housing authority compares with others;
- might encourage poorly performing local housing authorities to adopt the practices of the best, through public 'shame';
- makes local housing authorities think about the services they are providing and what standard of service is appropriate.

In terms of disadvantages, the following are widely suggested:

- many of the indicators are loosely defined, and authorities may, therefore, interpret them in different ways, e.g. arrears of over one week may be interpreted as one week of rent *payable* (which might be very little, net of Housing Benefit) or one week of gross rent (which could, in fact, represent 20 or more weeks of rent payable);
- the collection of data for performance indicators is time-consuming and diverts scarce staff resources from the actual provision of services;
- in many instances, the quality of service provided is not being monitored - only frequency or speed of response;
- 'league tables' do not allow local circumstances to be taken into account;
- most members of the general public don't ever see the indicators.

Code of Audit Practice

The Audit Commission also prepares a Code of Practice for local government auditors, embodying best professional practice. Local authority associations, accountancy bodies, and interested government departments are consulted over the contents of the Code, which is then subject to parliamentary approval. The Code sets out the duties of the auditor, the way in which audits should be conducted, and how the results should be reported.

As you will have noted, the central activities of the Audit Commission are very wide-ranging, but they result only in reports which have no statutory force. The Commission cannot force authorities to save money; it cannot determine what an authority's policies should be, how much it should spend, or where its priorities should lie. Though it can consider the consequences of an authority's policies and make comments on them, it gives only guidance and suggestions – it has no power of instruction.

However, when we consider the work of its appointed auditors with individual local authorities, a very different picture emerges.

3.4 District Audit

The District Audit Service carries out external audit functions for approximately 70% of local authorities. In the remaining 30% of cases, firms of private auditors are appointed.

The intention of the Commission in using private auditors is to achieve a blend of public and private experience. However, it recognises that local government is complex, and that special knowledge is needed, so only seven private firms are used, each of which is considered to have the necessary expertise available.

The Commission carries out annual quality reviews of the performance of both the District Audit Service and the private firms.

Where local authority audits are carried out by private firms, a partner in the firm will be vested with the same powers as those available to District Auditors. Both operate to the same Code of Practice.

Around 60% of the work of the external auditors in local government is on financial management. The remaining 40% is related to value for money audits.

A small amount of semi-consultancy work is also carried out under the direction of individual Chief Executives.

3.5 Statutory Duties

The statutory duties of the external auditor require the auditor:

- To ensure that the accounting of the local authority is legal, observes proper practices and secures economy, efficiency and effectiveness in the use of public funds.
- To offer constructive assistance to members and officers of the local authority.
- To certify completion of the annual audit and to express an opinion on the authority's statutory accounts, qualifying this where necessary, and reporting in public where it is in the public interest to do so.
- To be independent and objective, and to respond to elector's questions or challenges.
- To exercise due professional care and to comply with the Commission's Code of Audit Practice. This is regularly updated by the Commission and approved by Parliament.

The auditor is required to express a view as to whether an authority's annual accounts fairly represent its financial position. To do this, the auditor will examine all accounting systems and undertake a detailed review of the final accounts prepared by the authority.

The auditor will also seek to establish that the authority has appropriate management and financial procedures in place to safeguard against fraud and corruption.

Most importantly, the auditor must be satisfied that all of the authority's expenditure is legal, i.e. that it is doing only what it is allowed in law to do.

None of what we have heard so far indicates that the auditor has any real 'teeth' when it comes to forcing authorities to change their ways. Where, then, does the real regulatory might of the external auditor lie?

Auditors have a number of powers available through the Courts to deal with any matters involving illegality or financial losses caused by wilful misconduct.
If auditors consider than an authority is doing something that it has no legal right to do, they may apply to the High Court for a declaration that the related item of account is unlawful. Such action will only be taken after discussion with the authority. The auditor will want to establish:

- the intent of the authority when it undertook the action;
- the extent of any loss; and
- the likelihood of recurrence.

Court action will only be initiated where it is felt that this will serve a useful purpose.

Where auditors consider that the authority has wilfully incurred losses or has failed to account for money or goods, they have powers to order those concerned - members or officers - to repay the money. This does not require a Court Order, though there is a right of appeal for any person so charged against the auditor's decision. Such appeals are heard in the High Court.

Auditors also have powers to deal with significant issues involving illegality. In these instances, they may either:

- apply to the Courts for a judicial review; or
- serve a prohibition order precluding further such action. In this case, there is the usual right of appeal.

Because housing is a high profile service with a high spending profile, it is inevitable that a considerable amount of external audit attention focuses on housing activities, the Housing Revenue Account and capital expenditure through the Housing Investment Programme.

Auditors have legal power to obtain whatever information they feel is necessary from the authority and, as we have seen above, some powerful regulatory tools. However, it is important not to lose sight of the fact that their aim is not simply to criticise authorities and to point out their inadequacies. Rather, they seek to help authorities to solve problems and to encourage them to help themselves by following the best practices established elsewhere.

3.6 The RSL sector

The current system of regulatory review for RSLs in England was introduced in 1994. It is based on a 'desk top review' of information submitted to the Corporation by associations. This is in keeping with a general trend towards performance indicators and the production and publication of information about all aspects of performance.

The Housing Corporation publishes clear guidelines about what is expected (tenant's guarantee, performance standards, scheme development standards, etc.) and requires associations to certify that they comply. Associations are subject to little interference while going about their business, but can expect to be in trouble if they are found *not* to be complying with what is expected.

On the basis of the Association's returns, its overall performance is monitored, and financial health assessed. The four main criteria are:

- **Control**: organisation, management, financial controls
- **Conduct**: accountability to tenants, equal opportunities
- **Landlord function**: access to housing, housing management, maintenance
- **Development**: meeting identified needs, scheme standards, cost controls.

At the end of this process, a 'performance audit report' is issued, which simply states that an association either:

- exceeds the standards;
- meets the standards;
- fails to meet the standards but without giving cause for serious concern; or
- significantly fails to meet the standards.

In addition, developing associations are given a Performance Assessment and Investment Summary (PAIS). This is based on:

- the performance audit report;
- scheme audit;
- annual/quarterly accounts assessment; and
- a programme delivery assessment.

The overall process lays its emphasis on detecting where associations are failing to perform. It says little, however, about the relative performances of all those associations considered to be 'OK', and even less about anything qualitative.

Where performance is unsatisfactory, what can the Corporation do?

The Housing Corporation has wide-ranging statutory powers over RSLs.

- It can insist on detailed, direct supervision of an association, or institute a statutory enquiry.
- It has right of access to all records and information held.
- It can freeze or withhold development funding, remove or appoint Committee members and, ultimately, transfer assets and liabilities to another association.

However, the Corporation much prefers to sort out problems informally and on a voluntary basis. Often, the Corporation will have a clear view on what the end resolution of a problem is to be, make this clear to the association in trouble, and not have to take a public position, knowing that its advice will be followed.

When associations are in financial difficulties that cannot be put right by remedial action, merger with another association is the most frequent solution.

Activity 7

When was an internal audit of your organisation/department/section last carried out? What were its findings?

What sort of question does an internal audit section ask when it reviews a Department? (To do this you could interview an internal auditor but if this is not possible the questions can be inferred from the audit report.)

Who does the external auditing of your organisation? Is their last report a verification of the accounts, or did it deal with management and value-for-money issues?

Some councils have been the subject of the Audit Commission's review of the provision of Council Housing. Was your Council one of them? If so, what were the Commission's findings about your Council?
Note: You will be able to obtain an external auditor's report from your finance department but housing departments often hold copies of audit reports about themselves.

Your organisation must publish its Performance Indicators. How does it compare to others?

Time allocation: 60 minutes

Self Test 3

1. *What is the reason for an audit?*

2. *Describe some ways in which auditors might verify the accuracy and completeness of accounts.*

3. *Who might be interested in using the audited accounts of a company or institution, and for what purposes?*

4. *What is a management audit ?*

Now turn to the Answers at the end of the Block.

Summary

1. **All companies and institutions such as building societies, must keep proper accounts, prepare financial statements, and have them audited.**
2. **The object of an audit is to ensure that the accounts are a true reflection of the financial state of an organisation.**
3. **An audit is carried out by professional auditors, independent of the company or institution being audited.**
4. **In the public sector, an audit has the function of a management, as well as financial, audit. It produces performance indicators, such as unit costs, or levels of voids or arrears, by which the management efficiency and effectiveness of an organisation can be judged.**
5. **Statistics relating to housing finance and management performance are published by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the various local government associations.**
6. **The Audit Commission can examine a wide range of performance issues in local authorities.**
7. **Audited accounts are put to a variety of uses by different individuals, government and law enforcement agencies, and interest groups or institutions such as tenants, employees, and potential lenders. Their guaranteed accuracy is, therefore, of great importance.**

Answers

Self Test 1

1. (a) Capital items are fixed assets. Capital receipts (income) include proceeds from the sale of property, as in Right to Buy Sales, and equipment. Capital spending would be spending to create such assets - building, buying new equipment.

   (b) Revenue items include day-to-day running or management costs. So revenue spending can include repairs (as opposed to improvements) to property; office stationery, interest payments, salaries. Income under this heading may include rents, and sales of ephemeral items such as mugs or T-shirts.

2. They ensure that an organisation understands its own financial position, can monitor it, and use past records as a guide to budgeting for the future.

3. An estimate is made, as accurately as possible, of income for the year ahead. Money is allocated to different uses. Priorities in spending may have to be set if projected income does not match up to spending needs.

Self Test 2

1. Your answer may contain any of the following:
   - rent income
   - loan repayments
   - profits
   - savings on past income
   - interest in bank accounts, etc.
   - fees from customers
   - capital receipts

2. (a) for local authorities: borrowing from institutions, companies and individuals, and grants from central government.

   (b) for housing associations: government grant (HAG); private sector sources, especially building societies; and from cheap land deals, from local authorities.

(c) private landlords may be able to borrow from banks. If they are companies they can raise equity finance (by selling shares) or long term loans such as debentures, some may have obtained Business Expansion Scheme funds.

Self Test 3

1. The point of an audit is to establish that the statement of accounts is a true and accurate reflection of the affairs of the company or institution.
2. The auditors cannot check every detail of accounts. They will therefore take samples and test those. For example, they might check that information referring to a sample of sales appears accurately; they might have assets, such as buildings, valued; they might check that security for loans actually exists.
3. Many groups may be interested in audited accounts, for many different purposes.
    - Owners and customers will use them to assess management.
    - Employees may be interested, for the purposes of wage negotiations or profit sharing.
    - The courts may use them, to determine the legality of transactions.
    - Suppliers may be interested, to help assess credit-worthiness.
    - The Inland Revenue may use them to assess tax liabilities.
4. A management audit produces indicators which are used to monitor the performance of management. These "performance indicators" must be included in the Annual Report by Housing Authorities, so that its tenants can judge whether they are getting value for money.