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Adrian Waite (Independent Consultancy Services) Limited

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Dear Sir,

Last week saw CIPFA launch its global prospectus for improved public financial reporting and the government announce that Councils will be expected to take on £30billion in debt on their housing revenue accounts as part of the self-financing deal. Both announcements were made against the backdrop of serious concerns across Europe about public debt.

This led me to think about the proposals for financial reporting in the housing revenue account that have been developed by CIPFA in association with CIH and CLG and on which they recently consulted.

The proposal is to move away from the current method of valuing council housing (called Existing Use Value - Social Housing) to one based on cash flows. This is an accepted way of valuing an ongoing business – looking at the surplus that it could be expected to generate over the years and calculating a lump sum of equivalent value. It is the method of valuation used when council houses are transferred to a housing association.

However, the proposal from CIPFA is that Councils would look only at the income they can expect from council house rents over thirty years and not take account of their costs. I am told that this is consistent with International Financial Reporting Standards but it would result in what I would regard as an inflated valuation because it would ignore liabilities.

Let me give you an example from a Council in Eastern England with which I am familiar – using data that is available publicly. Under self-financing they are expected to carry £223million of debt.

Valuation based on gross cash flow (only taking account of income) would be £663million (an increase when compared with the existing valuation). Valuation based on net cash flow (also taking account of expenditure including that needed to achieve decent homes) would be £68million (a decrease when compared with the existing valuation).

The use of gross cash flow would produce a valuation of £663million compared with a debt of £223million – the business would be worth £440million. In contrast the use of net cash flow would produce a valuation of £68million compared with a debt of £223million. The business would have a negative value of £155million and technically would be bankrupt and trading illegally. The latter calculation is probably the most accurate.

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In all councils a valuation based on gross cash flow would be significantly higher than one based on net cash flow. In many councils the valuation based on net cash flow would be lower than the level of debt that is to be imposed on councils with self-financing.

Does this matter to anyone but technical accountants? The answer is certainly 'Yes'.

Steve Freer, Chief Executive of CIPFA, complained to the International Federation of Accountants' Council in Berlin that some public bodies 'do not maintain balance sheets. They do not systematically record and value assets and liabilities… A solution built on such fragile foundations is bound to collapse'.

I hope that the self-financing system does not collapse in some local authorities because of a combination of ignoring liabilities in calculating the valuation of council housing, increases in debt associated with self-financing and a lack of funding for decent homes. We will have to be careful in selecting our accounting policies and in evaluating the financial information that our accounts and balance sheets give us.

Yours faithfully

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