



## **Additional Agenda Item**

**This is a supplement to the original agenda and includes a report that is additional to the original agenda.**

### **Nottingham City Council Executive Board**

**Date:** Thursday, 28 April 2022

**Time:** 3.15 pm

**Place:** Tea Room - at the Council House

**Governance Officer:** Nancy Barnard, Governance and Electoral Services Manager  
**Direct Dial:** 0115 876 4312

<b>Agenda</b>	<b>Pages</b>
<b>10 External Review of Housing Financial Management and Council Response</b> Report of the Portfolio Holder for Housing, Planning and Heritage	3 - 86

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<b>Subject:</b>	External Review of Housing Financial Management and Council Response		
<b>Corporate Director(s)/Director(s):</b>	Sajeeda Rose, Corporate Director, Growth and City Development		
<b>Portfolio Holder(s):</b>	Cllr. Linda Woodings		
<b>Report author and contact details:</b>	Kevin Lowry Interim Director of Housing		
<b>Other colleagues who have provided input:</b>	Clive Heaphy, Corporate Director, Finance and Resources Beth Brown, Head of Legal and Governance		
<b>Subject to call-in:</b>	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	
<b>Key Decision:</b>	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	
<b>Criteria for Key Decision:</b>			
(a)	<input checked="" type="checkbox"/> Expenditure	<input type="checkbox"/> Income	<input type="checkbox"/> Savings of £750,000 or more taking account of the overall impact of the decision
<b>and/or</b>			
(b)	Significant impact on communities living or working in two or more wards in the City		
	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	
<b>Type of expenditure:</b>	<input checked="" type="checkbox"/> Revenue	<input type="checkbox"/> Capital	
If Capital, provide the date considered by Capital Board			
Date:			
<b>Total value of the decision: £750k</b>			
<b>Wards affected: All</b>			
<b>Date of consultation with Portfolio Holder(s): 23 April 2022</b>			
<b>Relevant Council Plan Key Outcome:</b>			
Clean and Connected Communities	<input type="checkbox"/>		
Keeping Nottingham Working	<input type="checkbox"/>		
Carbon Neutral by 2028	<input type="checkbox"/>		
Safer Nottingham	<input type="checkbox"/>		
Child-Friendly Nottingham	<input type="checkbox"/>		
Healthy and Inclusive	<input type="checkbox"/>		
Keeping Nottingham Moving	<input type="checkbox"/>		
Improve the City Centre	<input type="checkbox"/>		
Better Housing	<input checked="" type="checkbox"/>		
Financial Stability	<input type="checkbox"/>		
Serving People Well	<input checked="" type="checkbox"/>		
<b>Summary of issues (including benefits to citizens/service users):</b>			
<p>Nottingham City Council (NCC) is responsible for council housing and the operation of the Housing Revenue Account (HRA). These responsibilities are outlined in legislation (principally the Local Government and Housing Act 1989 and subsequent amendments) and any guidelines on operation of the HRA from Government. This responsibility cannot be delegated.</p> <p>Housing Management and Maintenance functions can be delegated and since 2005 NCC has arranged that Nottingham City Homes (NCH) manage HRA funds on behalf of, and under the control of NCC. NCH is a wholly owned Company and a Partnership Agreement is in place covering working arrangements between the NCC and NCH. NCH acts as an Arms' Length Management Organisation (ALMO) and was originally set up to access Decent Homes Funding. It is recognised that beyond investment to achieve decent homes standards, NCH has had success in improving core housing services. NCH have achieved improvements to housing stock, including the response to fire safety following Grenfell and home insulation works. The Council will want to build on the improvements made to date in terms of housing quality and safety standards.</p>			

HRA funds are for the benefit of the council's tenants and leaseholders and are funded primarily by rents and service charges. The HRA is a strictly ring-fenced account of the General Fund (GF) for specific purposes set out in the legislation and guidelines.

A review commissioned by the Council has identified that NCC, including through its arrangements with NCH, has acted unlawfully in relation to breaches of the HRA Ring Fence.

The issue was previously reported to and considered at an Extraordinary meeting of Full Council on 4 January 2022. Amongst other actions agreed, two further reports were commissioned. This paper addresses key points arising from the findings of these two reports by an independent investigator, Richard Penn and CIPFA (Chartered Institute of Public Finance and Accountancy).

The further work commissioned from Richard Penn and CIPFA, following the identification of initial breaches, has identified the causes of the unlawfulness and how it came about and that the scale of unlawful use of funds diverted away from the HRA is greater than first identified.

CIPFA's initial report identified the unlawful treatment by NCC of the NCH 'management fee rebate' which was valued at £14.367m. CIPFA's additional work has uncovered a further sum of up to £25.759m of detected and assessed issues taking the overall scale of the issue of up to £40.126m. This comprises:

- i) Issues raised in the original report concerning the unlawful treatment by NCC of NCH 'management fee rebates of £14.367m (35.8% of the total).
- ii) Issues forming workstream A of CIPFA's review which concerned historical decisions taken by NCC without full consideration of the HRA ring-fence totalling £8.503m (21.2% of the total).
- iii) Issues forming workstream B of CIPFA's review which concerned the extent to which HRA monies have been spent by NCH on non-HRA activities between 2014-15 and 2020-21 totalling £17.158m (43.0% of the total).

The investigations the council has commissioned have identified issues with historical financial mismanagement, a lack of adequate record keeping and governance failures that have occurred. Consequently, it is important that the council acts swiftly and decisively to deal with the matters raised to provide assurance to itself, tenants, taxpayers, the Improvement and Assurance Board and Government. Members will need to have confidence that officer and external auditor advice is robust and consequently that the council's accounting and use of HRA is legal and passes the 'who benefits' test to ensure that the impact of HRA monies are spent in accordance with the ring fence for the benefit of Council tenants.

As well as rectifying past omissions and learning lessons, a key focus looking forward is on ensuring that decisions are taken which makes sure that these unlawful events cannot happen again. This includes clarity of roles for those responsible for safeguarding the HRA ring-fence, clear performance and financial controls within the council and in relation to the management of NCH, close monitoring of spending in the HRA, improved governance including enhancing the role of scrutiny and clear records to support future decisions around spending within the HRA..

**Does this report contain any information that is exempt from publication?**

**no**

### **Recommendations**

1. To receive and note the Key Findings Report from Richard Penn following his independent investigation (Attached as Appendix 1).
2. To receive and note the further work undertaken by CIPFA (including appendices relating to workstreams A and B). (Attached as Appendix 2)
3. To note that the current organisational arrangements between the NCC and NCH do not provide officers sufficient assurance that the HRA ring fence can be adequately protected under existing arrangements, and in turn councillors have been unable to gain the required level of assurance in relation to the HRA ring fence.
4. To authorise the Corporate Director of Finance and Resources and Section 151 Officer, following the receipt of further work from CIPFA outlined in this report, to seek a Ministerial Direction from government to repay in aggregate up to £40 million from the General Fund to the HRA (subject to any mitigations to reduce this sum).
5. To note the options and key lines of enquiry for funding the rectification of the breach to the HRA ring fence and to note that there will be an impact on the 2022/23 – 2025/26 MTFP which will be reported to Executive Board and/or Full Council in due course.
6. To approve, the serving of a 12 months' Notice to Terminate on NCH in respect of its housing functions and to take over direct management of council housing from the expiry of that notice period or sooner by agreement.
7. To note that should the recommendations of this report be accepted, there will be engagement with tenants and leaseholders to ensure a smooth transition and continuity of service about ongoing service provision. This will include how the voice of tenants will be heard by NCC as the landlord after the service is brought under direct control.
8. To authorise the Corporate Director of Growth and City Development to take such steps as may be necessary to deliver an effective transfer of housing management functions back to the Council, in consultation with the Portfolio Holder for Housing, Corporate Director of Finance and Resources and Section 151 Officer and Director of Legal and Governance and Monitoring Officer. This to include, amongst other things, arrangements for the protection of employment rights for NCH staff through TUPE transfer, arrangements for effective tenant and leaseholder engagement and empowerment in the decision making about services, and the transfer of relevant third party contracts and any other relevant arrangements as may be necessary to support an effective transition.
9. To authorise the Corporate Director of Growth and City Development to take such steps as may be necessary to affect such short term and practical arrangements in relation to the governance arrangements of NCH to facilitate an effective transition, in consultation with the Portfolio Holder for Housing, Corporate Director for Finance and Resources and Section 151

<p>Officer, the Corporate Director of Resident Services (in their capacity as the shareholder representative for NCH) and Director for Legal and Governance and Monitoring Officer, including positive liaison with the NCH Board and effecting any changes that may be necessary to the Articles of Association of NCH and Board appointments.</p>
<p>10. To delegate to the Corporate Director of Growth and City Development a provisional budget of £750,000 to deliver on the above recommendations from HRA funds, as a proper use of those funds, in consultation with the Portfolio Holder for Housing, Corporate Director for Finance and Resources and Section 151 Officer and Director for Legal and Governance and Monitoring Officer.</p>
<p>11. To note that a report is brought back to Executive Board and subsequently to Full Council to identify arrangements for a greater level of councillor engagement in overview and scrutiny arrangements for policy development, priority setting and holding to account for performance in relation to housing management matters, following the return of management of the council's housing stock to the council.</p>
<p>12. To note that the Overview and Scrutiny Committee will receive update reports to enable the implementation plan and consultation arrangements to be reviewed during the transition through the Council's scrutiny arrangements.</p>

## 1.0 Background

- 1.1 In the late summer 2021, the Section 151 officer became concerned with both the use of funds within the NCH Group (NCH Enterprises Ltd and NCH Register Provider Limited) and how a substantial value of HRA funds repaid by the Council found their way into the Council's General Fund. In respect of this and with the support of the Leader and Deputy Leader of the Council, an investigation was commissioned and conducted by CIPFA.
- 1.2 On 15<sup>th</sup> December 2021, the Council's Section 151 Officer issued a report under section 114(2) of the Local Government Finance Act 1988. At the same time, the Monitoring Officer issued a further report under section 5 of the Local Government and Housing Act 1989. Both reports were issued in respect of acts of unlawfulness by the Council in respect of "management fee rebates" made to the Council by NCH over the period 2014/15 to 2020/21 inclusive.
- 1.3 This issue has arisen following a difficult period for the Council during which the Council has had to take extensive action to address the various issues raised. These actions have included working with the Department for Levelling Up, Housing and Communities (DHLUC) who, in conjunction with NCC, and have established an Improvement and Assurance Board which reports to the Secretary of State.  
The Improvement and Assurance Board are monitoring the response to the HRA issues, just as they have the wider Together for Nottingham Plan (formerly the Recovery and Improvement plan) and are seeking timely and effective action to address the matters at hand.
- 1.4 Full Council considered the Section 114 and the Section 5 Notice at an Extraordinary Council meeting on 4 January 2022. The Council accepted the

Section 114 Notice and its recommendations in full. This included commissioning further reviews to understand how this practice had occurred and next steps including what would be required to ensure that there is no repeat in future. Specifically, Council agreed to:

- i. Carry out a review of the processes and systems that failed to prevent the unlawful breaches to ensure that they cannot be repeated. This will include a review process in respect of 'novel' proposals by appropriately trained and experienced staff.
- ii. Commission legal advice on the lawfulness of the transactions and in consultation with the Department for Levelling Up, Housing and Communities, the Improvement and Assurance Board and the Council's external auditors, consider what further actions are necessary.
- iii. Examine in detail the chronology of events in relation to the payments Nottingham City Homes has made to the Council including who conceived the payment, the accounting transaction detail, who authorised it, who knew about it, how challenges to the legitimacy of the payment were dealt with and by whom and any other facts that can provide insight into how the situation came to be.
- iv. In the event that the Section 151 Officer considers that the General Fund is required to repay the Housing Revenue Account and Nottingham City Homes, consider how the Housing Revenue Account or Nottingham City Homes should be additionally recompensed to reflect the opportunity cost of not having access to funds they may have been entitled to.
- v. As a consequence of the concerns raised by the Section 151 Officer and the work undertaken and conclusions drawn by CIPFA, examine and resolve other potential breaches of the Housing Revenue Account ring-fence.
- vi. Further analyse the finances of the Nottingham City Homes Group to provide assurance that Housing Revenue Account funds have been properly applied and not used inappropriately to fund non-Housing Revenue Account activities undertaken by Nottingham City Homes, which could potentially breach the integrity of the Housing Revenue Account ring-fence. This will involve a forensic financial examination of:
  - a. transactions for services flowing between the Council and Nottingham City Homes; and
  - b. Transactions for services flowing between Nottingham City Homes and its subsidiaries.
- vii. Review the adequacy of the Housing Revenue Account client function in order to assess whether it is sufficient to properly scrutinise the activities of Nottingham City Homes and provide the proper strategic direction, controls and assurance on behalf of the Council as the Local Housing Authority.
- viii. Consequential to CIPFA's work and in light of the changes that have taken place in how Local Housing Authorities provide housing management since the end of the Decent Homes Programme,

commission a review of the Council and Nottingham City Homes Group relationship and future operating model to include the purpose, structure, finances and governance in relation to the housing management function as set out in the Recovery and Improvement Plan.

- 1.5 The two further reports by Richard Penn, a highly respected and experienced Local Government Investigator, and CIPFA have now concluded and the terms of reference, key findings and recommendations are detailed below.

## **2.0 Further reports received**

### **2.1 The Penn Report**

In conducting the review Richard Penn analysed the initial CIPFA report and other relevant documentation. He conducted numerous interviews with current and former members and senior officers of the Council and NCH. His Key Findings Report (the Penn Report) is attached at Appendix 1.

The Penn Report was commissioned to answer four fundamental questions.

- *Who conceived the payments, who authorised them and accounting transaction details?*
- *Who knew about the payments?*
- *How challenges to the legitimacy of the payments were dealt with and by whom?*
- *Any other facts that may provide insight into how the situation came to be.*

Findings and recommendations from the Penn Report are set out below in section 3.

### **2.2 CIPFA Report**

- CIPFA's Phase 1 report identified the potential for further breaches of the HRA ring-fence in two specific areas which have been the focus of the Phase 2 work.
- In examining the issues raised, CIPFA have taken into account the [then] MHCLG's 2020 guidance on operation of the HRA ring-fence together, where appropriate with any earlier guidance in relation to the HRA (namely Circular 8/95).
- CIPFA have now undertaken the work set out in 1.3iv) above and a draft report is attached with separate appendices for the two workstreams namely.
  - transactions for services flowing between the Council and NCH (Workstream A); and
  - transactions for services flowing between NCH and its subsidiaries (Workstream B)

Findings and recommendations from CIPFA are set out below in section 3.13

### 3. Conclusions and recommendations

#### 3.1 Penn Report

The Penn Report identified, amongst other things, a lack of alignment in the interests of NCH and the Council in relation to the management of the HRA. NCH consider that they have no responsibility in the management of the Council's HRA funds to account properly for HRA and non HRA funds and as such the current organisational arrangements between NCH and the Council are not fit for purpose, not sustainable and expose the Council to risk. This is all in the context of the current intervention arrangements with an Improvement and Assurance Board being in place to oversee the Council's improvement journey in relation to strategic financial management, governance and culture.

3.2 The Penn Report concludes that the payments in question were conceived initially by the then Corporate Director of Development as part of a wider and ongoing budget and savings exercise. The concept of the payments would have been evaluated by a working group of officers and councillors, and subsequently agreed at budget meetings by the Executive.

3.3 Having been adopted in 2014-15 these savings/payments became a standard expectation of the budgeting process. The Penn Report concludes that it was not case that the payments were a "*mechanism conceived to divert HRA funds to the General Fund (GF)*". However, it is clear that the annual rebate received by NCC was used to benefit the pressures on the GF, and that as the annual expectation of savings/payments grew "*it is likely that this became an accepted mechanism to divert funds from the HRA to the GF*".

3.4 Awareness of the payments was wide and covered many officers of NCC and NCH as well as Councillors. The budgetary process was in the public domain and the information was widely available. Specific reference is made to the fact that at the inception of the first tranche of "savings" in 2014-15 the s151 Officer, the Director of Finance and the HRA Finance expert were all sighted on the proposal and none of them raised concerns about its legitimacy. After the in-principle agreement to this proposal no further concerns were raised by officers later in the process, including the Monitoring Officer or any of the Legal team.

3.5 There appears to have been little or no challenge as to the legitimacy of the proposed savings regime either within NCC or NCH. Where officers, Councillors or NCH Board members, in their interviews, indicated that they did raise concerns they were apparently either reassured about legitimacy, ignored, or dissuaded from voicing their concerns wider.

3.6 NCH Board raised concerns about the growing scale of required savings but appear not to have overtly challenged the HRA ring fence nor the lawfulness of directing HRA funds to the General Fund.

3.7 NCH have sought their own independent legal advice and still dispute, based on that advice, the conclusions of the S.114 report, the section 5 report and CIPFA as

to the unlawful breach of the ring fence. The Penn Report makes no attempt to adjudicate on this.

3.8 The Penn Report does not conclude that the savings were a mechanism conceived to divert HRA funds to the General Fund but does conclude that there were widespread failures of governance. Particular mention is made of NCH's failure to challenge. *"NCH .... had a sufficient knowledge of the HRA ring fence to know that returning surpluses back to the Council to help with General Fund budget pressures could not be justified but they went along with the proposal."* The Chair of NCH did report that there had been a formal enquiry challenging the use of HRA, but this did not result in any form of review or revision of the approach.

3.9 The Penn Report observes that *"This episode has been a disappointing setback for the Council on an improvement journey which has centred on improving strategic financial management and governance – poor examples of both have been identified through this investigation. Notwithstanding that, that the issue has been identified and dealt with quickly by the Council itself demonstrates that the improvement journey is very much on track"*.

The Penn Report makes the following recommendations.

#### 3.10.1 Relationship with NCH

- *Having regard to the CIPFA Review and this investigation, urgent consideration is given by the Council to bringing back 'in house' the management of the Council's housing stock and related functions.*
- *Between now and when a 'Notice to Terminate' is served, the Council to expedite the significant strengthening of the governance arrangements applied to NCH, to ensure that the Council can demonstrate and exert the required control over NCH as a wholly owned Teckal company, to provide the necessary assurance over the management of the Housing Revenue Account.*
- *This should include amending the Articles of Association, the rules governing how the company operates lodged at Companies House, to give the Council the right to appoint and dismiss the Chair of the Board and the Chief Executive.*
- *Penn also recommended the ongoing strengthening of the Council's local housing authority role, to include effective client arrangements of NCH, together with the undertaking of project planning for the return of council housing management to the Council, with the necessary resources being allocated.*

#### 3.10.2 Improved governance within NCC

- *Arrangements should be made for additional advice, guidance and support for the Council's Finance Team including external support and expertise.*
- *that the Monitoring Officer and the s151 Officer should be formally and more actively involved than has been historically the case in fulfilling their statutory responsibilities for the provision of advice to elected members on any proposed action by the Council that could potentially be unlawful along with the Chief Executive, as the Council's third statutory officer.*
- *That any such advice from the Council's three statutory officers must be fully respected by both members and officers and given due weight in the Council's*

*decision-making processes.*

- That the Council's External Auditors should be required to have a greater focus on how the Council is taking decisions and responding to the advice from the Council's statutory officers rather than relying on 'materiality' to trigger potential intervention.*
- Whilst the operating environment may have been considered challenging or difficult, the investigation has found that a number of former NCC officers fell below the standard that could reasonably be expected in showing the necessary intellectual curiosity, and providing clear advice about the inappropriateness of action by the Council in this regard.*
- The Council should seriously consider passing details of the CIPFA Report and this (Penn) Report to relevant professional bodies where relevant professional qualifications were and are held, for those professional bodies to determine whether they wish to consider any support, guidance or action in this matter. This would be a serious step and proper consideration needs to be given to the relevant evidence before any such action is taken to avoid potential litigation.*
- That the Council's Constitution - including the various Codes of Conduct - should be critically reviewed to ensure that the lessons learned from this experience have been fully encapsulated in the requirements set out in the Council's Constitution.*

### 3.11 CIPFA Report

The further report from CIPFA is attached at Appendix 2 and has drawn the following summary of conclusions.

CIPFA's findings in their original report focussed on the unlawful treatment by NCC of the NCH 'management fee rebate' and was valued at **£14.367m**, which was the subject of the initial report to Council on the 4<sup>th</sup> of January 2022.

CIPFA's additional work has uncovered a further sum of up to **£25.759m** of detected issues taking the overall scale of the issue as up to **£40.126m**. This is based on a detailed review although given the lack of data and supporting evidence in some areas, CIPFA have had to rely in some areas on estimates and extrapolations to arrive at the financial impact over the last seven years.

The issue can be broken down into three main parts.

- Issues raised in the original report concerning the unlawful treatment by NCC of NCH 'management fee rebates' of **£14.367m** (35.8% of the total).
- Issues forming workstream A connected to historical decisions taken by NCC without full consideration of the HRA ring-fence, presented as a non-negotiable requirement to those responsible for administering the HRA totalling **£8.503m** (21.2% of the total). Further issues have been identified which may vary this total further.
- Issues forming workstream B connected to the extent to which HRA monies have been spent by NCH on non-HRA activities between 2014-15 and 2020-21 totalling **£17.158m** (43.0% of the total).

In relation to **workstream B** which focussed on the treatment of funds within NCH and the NCH group, CIPFA conclude that.

3.12 *"In our opinion, the duty on NCC to ensure that HRA monies are only spent to the benefit of HRA tenants does not cease when it delegates the service provision to an arms-length management organisation. On the basis of our analysis, the failure to require its arms-length management organisation (NCH) to maintain this ring-fence for its operations means that, in addition to the £14,366,500 payments to the NCC General Fund that need to be remedied, a further £17,256,213 of HRA funds between 2014-15 and 2020-21 were not utilised by NCH on HRA activities by 31 March 2021. This estimate is based on the assumption that NCC funding reconciles with the records held by NCH."*

3.13 CIPFA specifically comment in relation to workstream B that.

1. *Funding from the ring-fenced HRA account received by NCH between 2014-15 and 2020-21 exceeded its spending on HRA activities, that the scale of the gap does not take into account the annual payments made by NCH that NCC credited to the GF and that the capacity for NCH to remedy this gap without support from the Council is very limited.*
2. *CIPFA have not seen any evidence that NCH has the appetite to ring-fence HRA funding and expenditure from its non-HRA activities.*
3. *CIPFA find that the ledgers kept by NCH do not differentiate between HRA and non-HRA activities and as a result, separating HRA funding and expenditure within NCH has proved very difficult. As NCH does not consider that it has any obligation to ring-fence HRA funds, there is no statement or prime records available to show how such monies received have been applied each year.*
4. *Difficulties in identifying how HRA funds have been utilised are compounded by out-dated recharges between account codes that CIPFA could not validate and they were unable to adequately confirm the number of properties managed on behalf of the Council as specified in NCH's financial statements for 2020-21.*

3.14 Recommendations from CIPFA in relation to NCH through workstream B are.

1. *NCC should, as a matter of priority, revise existing funding agreements with NCH to specify an obligation to ring-fence HRA activities, including the production of an annual statement that shows the funding received and how it has been utilised.*
2. *Having established the extent of HRA funding that has not been utilised for HRA activities, determine whether NCH has the capacity to remedy this matter without financial support and if it cannot (as seems likely) consider how the Council would fund a further £17,158,617 to replenish the HRA.*
3. *Alongside the actions to introduce an HRA ring-fence, the basis of costings and recharges for work done by NCH and its subsidiaries needs to be updated, with the onus on actuals rather than estimates. A similar approach should be used for all other services provided to subsidiaries and other organisations.*

3.15 In relation to **workstream A** which focussed on the treatment of funds charged by NCC to the HRA, CIPFA conclude sums of £8.3m should be repaid from the General Fund to the HRA.

1. *On the basis of the evidence that was provided to CIPFA and conversations with NCC staff in relation to this evidence, we conclude that a number of decisions have been taken that cannot be justified and appear to undermine the HRA ring-fence.*
2. *The details of this undermining are set out in the CIPFA report but relate to charges for items which should not, under DLUHC guidance be charged to the HRA and/or where charges are being made, the evidence and basis is not obviously evidenced and thus without basis.*
3. *In addition to the above there are other issues that we [CIPFA] have examined where a firm conclusion cannot be made on the fairness of the charges made to the HRA since there is no clear basis or SLA on which these charges are based. In particular, we would draw attention to the £500,000 charge that was introduced in 2019-20 for Corporate and Democratic Core. No evidence has been provided to support this new charge.*

3.16 CIPFA have recommended that

1. *NCC considers our conclusions in relation to each of the items that combined have a value of £8,503,030 and determines:*
2. *The amount the HRA should be reimbursed (taking into account any interest that might have accrued on the sums to be paid to the HRA)*
3. *Any adjustments that might be necessary to reflect these amounts are based on historical values which may well have changed since the relevant decisions were taken.*
4. *The actions needed to rectify these items from 2022-23 onwards*
5. *Undertake work in relation to all charges to the HRA from the GF to provide a sound basis for the calculation of such charges combined with SLAs that have sufficient granularity to support these charges and any changes over time.*

## **4 Council Response**

4.1 The Council accepted in full the recommendations made at the Extraordinary Council Meeting on 4 January 2022. The Council commissioned further reports which are integral to the recovery process that the Council has embarked upon.

4.2 It is of deep concern that notwithstanding the seriousness of the issue, as evidenced by the service of a Section 114 Notice, a Section 5 Notice and exchanges of correspondence between the Chair of the Improvement and Assurance Board and the Minister in relation to the HRA issue, that CIPFA, as part of their most recent work, have reported that they have seen no evidence of measures to properly separate HRA and non HRA funding and expenditure. As a result, the Council cannot be sufficiently assured that the HRA ring fence is appropriately protected.

4.3 The advice in the reports and in this report are evidence based or founded on the most reasonable assumptions that could be made at the time. For this reason, officers strongly advise that the findings of the Penn Report and CIPFA should be accepted in full and the recommendations in this report accepted and implemented. The recommendations include rectifying the deficiencies identified and ensuring that future governance and financial controls are adequate and strengthened to protect the ring fence.

4.4 To achieve this, it will be necessary to strengthen the Council's technical and professional capacity and capability on HRA and Housing to implement this effectively. The current year accounts (2021/22) and the MTFP will be impacted and this could result in a potential gap each year. This will be considered in due course via the appropriate governance routes and mitigated to ensure the financial stability of the council. There will be further work in regard to the values reported to ensure that the precise sum for repayment is identified.

4.5 Further the oversight of any future charges to the HRA will be undertaken by the Interim Director of Housing and the Senior HRA accountant who will both act as "HRA Champions" for the Council and provide that required assurance to the Council regarding the future management of the HRA. As part of broader tenants and member involvement in relation to the council housing function of NCC, the Council will establish governance and oversight arrangements in relation to the HRA for members and tenants that are based on best practice in the sector. In addition, the Council will strengthen the role of the Council's Scrutiny arrangements to strengthen the overall governance arrangements covering the management of housing and the HRA.

4.6 Recommendation 6 is to bring the Housing Management function back "in-house" by service of 12 months termination in accordance with Clause 59.3 of the 2020 Partnership Agreement. This will mean the return to the Council of the direct management of council housing from the expiry of that notice. This can be effected earlier by agreement between the parties.

4.7 This process will include undertaking the necessary due diligence and project planning to bring housing management staff into the council, address and where appropriate transfer contracts, resolve issue relating to assets and balance sheets and ensure that existing housing management and services remain the same for tenants. NCC will remain as the landlord.

4.8 This will also include making any changes that may be necessary to the Articles of Association of NCH and Board appointments in the interim period.

4.9 This project will incorporate the necessary engagement and communications work to reassure staff and tenants. The Penn Report firmly recommends that in order for the Council to be able to demonstrate the necessary level of assurance over the use of HRA funds and during the transitional phase there will be a requirement for strengthened financial management, together with appropriate transition management arrangements to provide in improved level of assurance in the management of the HRA.

4.10 It should be noted that the process of reverting services back to the host Local Authority is now a common practice. From the initial creation of Housing ALMO's to gain Decent Homes grant funding from Government in the early 2000's, there were nearly 70 ALMO's. As Decent Homes Grant Funding is no longer available, many local authorities have taken the services back and there are now only just over 20 ALMOs still operating.

4.11 It should be noted that the Together for Nottingham Plan already includes an action to review Council companies and subsidiaries. Progress on this issue will be monitored by the Companies Governance Executive Committee.

## 5 Technical Steps to deliver recommendations

5.1 It should be noted that there is no recommendation from the Penn Report or CIPFA to enter into a full options appraisal. Where there is unlawful activity in regard to HRA and in the context of the existing Together for Nottingham Plan to address other financial issues, the Council needs to act decisively and quickly for the benefit of tenants.

5.2 To terminate the agreement with NCH notice should be served under 59.3 of the 2020 Partnership agreement which states:

*"The Council will be entitled to terminate the Agreement at any time on giving not less than 12 months written notice to the Organisation."*

5.3 At the expiry of the notice period (or sooner by agreement) the service would be transferred to the council by a "lift and shift". This means that the staff involved in day-to-day delivery will continue to provide customer service and tenants and leaseholders will experience a seamless transition. This reversion of the service is to allow greater accountability for the use of rent payer's money and to retain services under the control of the Council.

5.4 A detailed project plan will be developed that includes, but not limited to:

1. **Clarity of decision.** Why the agreement is being terminated and what NCC hope to achieve by in sourcing.
2. **Governance.** Project Boards at various levels to oversee the project and to ensure engagement with key parties of tenants, leaseholders, staff, unions, stakeholders and contractors.
3. **Resources.** There will need to dedicated capacity in particular in the areas of legal, finance (HRA), HR and communications. A budget of £750k to support NCC and NCH will be required. This will cover the costs of legal and professional services and will be drawn from retained HRA.
4. **Communications plan.** A detailed and timed communications plan aimed at all levels of engagement and progress including reactive capacity for press enquiries etc.,
5. **Risk Register.** A detailed and RAG rated living risk register covering impacts on the Council as well as NCH. The risk to service disruption has to be mitigated.
6. **Tenant engagement.** Notwithstanding the references at 2 and 4 above an engagement programme to develop how tenants will communicate with their landlord (rather than the landlords agent as at present) will be critical and

consistent with the emerging White Paper requirements, consumer standards and Tenant satisfaction measures (TSM's).

7. **Subsidiaries.** NCH have two subsidiaries. Careful consideration will be required in terms of the legitimate use in the future and protecting the benefits they provide for NCC e.g., provision of temporary accommodation.
8. **TUPE.** The proposal is for a "lift and shift" which means that the service would transfer back to NCC intact. The workforce of NCH would transfer to NCC and the legal and practical engagement processes including consultation and engagement with unions and staff will be observed and commence early in the process.
9. **Post transfer structure.** Building the council department that will bring together delivery services from NCH and strategic housing functions currently delivered in various departments within NCC structures
10. **HRA.** Dedicated resources are needed to implement the Penn and CIPFA recommendations.

## 6. Consultation Process

6.1 There will not be a formal tenant referendum exercise prior to serving Notice of Termination to NCH. This is because council tenants will remain tenants of the Council and housing management services will remain the same and will continue to be delivered in the same way. There are no proposed changes to service or policy warranting a referendum but we are seeking to deliver on the themes emerging from the Social Housing White paper, the new Tenant Satisfaction measures, Consumer Regulations and the fire and building safety agenda. Tenants will be engaged with and supported to work with the Council to review services and develop any service designs for the future as required by section 105 of the Housing Act 1985. The Council proposes to create a forum for tenants to not only oversee the smooth transition of services, but to develop the way in which tenants can interact directly with their landlord rather than the agent of the landlord. They will be supported in this process by an Independent Tenants Friend (ITF) who will be able to support and advise. This will be an independent individual or agency that can provide technical information and advise about the meaning and impacts of the proposals. Tenants will be involved in their appointment. We will want to ensure that the model of tenant and leaseholders' engagement is meaningful and influential and meets best practice standards.

6.2 There will be an extensive communications and engagement strategy for tenants and staff embedded in the processes.

6.3 Colleagues in NCH and NCC will be engaged and included in the transition process. NCH staff and unions will be formally consulted as part of the TUPE process.

## 7 Other options considered in making recommendations

7.1 This report proposes robust, swift and decisive action to address acts of unlawfulness in relation to breaches of the HRA ring fence by the Council including through its arrangements with NCH.

7.2 An alternative approach would be to retain NCH as an ALMO and to explore with its management the necessary improvements that the Council requires to be made. This

approach has been rejected as the governance and financial controls are not fit for purpose. CIPFA have advised that they have seen no evidence from NCH of an appetite to ring-fence HRA funding and expenditure from its non-HRA activities, and moreover NCH considers that it has no obligation to ring fence HRA funds. Given the seriousness of the issue and gravity of the situation that the Council faces, in the light of evidence received this alternative approach is considered untenable and has been rejected.

## **8 Finance colleague comments (including implications and value for money/VAT)**

1. CIPFA's initial work which focussed on the unlawful treatment by NCC of the NCH 'management fee rebate' and was valued at **£14.367m**.
2. CIPFA's additional work in response to the Section 114 report has uncovered a further sum of up to **£25.759m** of detected and assessed issues taking to overall scale of the issue of up to **£40.126m**. This comprises:
  - i. Issues raised in the original report concerning the unlawful treatment by NCC of NCH 'management fee rebates' of **£14.367m** (35.8% of the total).
  - ii. Issues forming workstream B of CIPFA's review related to the extent to which HRA monies have been spent by NCH on non-HRA activities between 2014-15 and 2020-21 totalling a further **£17.158m** (43.0% of the total).
  - iii. Issues forming workstream A of CIPFA's report related to historical decisions taken by NCC without full consideration of the HRA ring-fence, presented as non-negotiable to those responsible for administering the HRA totalling **£8.503m** (21.2% of the total).
3. CIPFA have spent in excess of 7 months undertaking this work. During that time, they have strenuously and robustly sought evidence from both NCC and NCH to evidence charge made by NCC to the HRA and charges within the NCH group. It is clear the level of justification, to support charges and the basis and allocation of costs has not been present and as a result CIPFA have had to draw conclusions from incomplete workings.
4. CIPFA's additional work in response to the Section 114 report has uncovered a further sum of up to **£25.759m** of monies potentially owed by to the HRA. This may be in cash or could potentially be in the form of assets transferred to HRA ownership.
5. The maintenance of an absolute ring-fence is one of the most fundamental principles of local government finance well understood by members and officers and its breach on this scale represents a major breakdown in controls, governance and financial management and requires the council to ensure that officer advice is clear, based on the latest legislation and well informed
6. CIPFA have, wherever possible over a number of months, sought to get firm evidence to support their conclusions and arrived at a firm conclusion on the value of the breach to be remedied. However, in spite of their efforts, it is clear that the Council's poor performance (and to some extent that of NCH) to maintain adequate

SLA's, records pertaining to the basis for charging, working paper, written rationale for not adopting Government guidance, has led to CIPFA being required to make approximations and estimates in some areas in arriving at their conclusion. Such an approach is entirely reasonable and normal in the accounting world – the lack of evidence on the part of NCC and NCH is of concern.

7. Whilst the Council can do further work to try to make these figures more precise, the main possibilities lie in the area of assets not SLA charges where further work is just as likely to result in an increased deficit as a reduced one. It is strongly recommended that the figures identified by CIPFA are accepted and that NCC seeks a direction from DLUHC to pay up to £40.1m from General Fund source to rectify past wrongs
8. This does not mean that further work should not be done to seek to mitigate this figure and the most likely area is in relation to assets held by NCH Enterprise and the NCH Registered Provider companies but arguably paid for by surpluses generated by HRA activities. There are no guarantees of a successful strategy, but it is clear that work is needed. Other areas are unlikely to yield any meaningful mitigation.
9. Further review work will need to undertake to assess and evidence an appropriate value of transactions between HRA/GF for the future and to potentially mitigate the total figure to be repaid.
10. The funding of this identified sum of up to £40.1m (before mitigations) will be a challenge for a Council whose finances are already stretched. The first c£15m has already been earmarked from General Fund Reserves to remedy the phase 1 issue of the misappropriation of "management fee refunds". In the absence of mitigations, a further £25.1m would need to be found. Taking these from reserves could well leave the Council vulnerable to managing service demand and other inflationary pressures.
11. An alternative approach could be to consider a request to DLUHC for a further capitalisation direction up to the full value or a mix reserves and capitalisation. Further work will be needed to draw a final conclusion on the optimised funding route.
12. The issues identified by CIPFA, whilst historic, will impact on the current MTFP and lead to a budget deficit rather than balanced budget. This will require further financial modelling and re-consideration of the S151 officer assessment of the robustness of the budget.
13. In addition, further urgent work will need to be undertaken to provide clarity on the financial framework which NCC expect NCH to operate within and the controls and monitoring regime and to provide the statutory officers with the necessary assurance that the integrity of the ring fence will be maintained.
14. In relation to the work to bring NCH in-house, this will require a dedicated project team to be established to drive the work around HR (TUPE transfer), procurement (contract transfer or termination) and assets management alongside the other workstreams
15. The cost of this is estimated at £750k subject to detailed cost estimates. This is a legitimate charge to the HRA and will be met from HRA reserves.

16. Further work may be needed, especially around the rationalisation of the NCH Group Company structure and the Companies Governance sub-committee will have oversight.

Clive Heaphy, Corporate Director, Finance and Resources 25<sup>th</sup> April 2022

## **9 Legal colleague comments**

- Nottingham City Homes is a wholly owned Council Company established in 2005.
- Since its establishment Nottingham City Homes have established two subsidiary companies, Nottingham City Homes Enterprise Limited and Nottingham City Homes Registered Provider Limited.
- The relationship between NCH and NCC is governed in accordance with a partnership agreement, most recently updated in September 2020.
- Clause 59.3 of the Partnership Agreement states that the Council are entitled to terminate the partnership Agreement on giving not less than 12 months' written notice to Nottingham City Homes.
- The notice period can be shortened with the agreement of both parties in writing in accordance with clause 64.1.
- Once notice to terminate has been given to Nottingham City Homes the Council must ensure that matters of housing management as set out in section 105 of the Housing Act 1985 remain unchanged. Any change which substantially affects secure tenants would require a formal consultation process to be undertaken.
- In accordance with the Local Government and Housing Act 1989 the Council has a duty to keep, in accordance with proper practices, an account, called the Housing Revenue Account ("the HRA").
- The HRA must record expenditure and income on running a council's own housing stock and closely related services or facilities, which are provided primarily for the benefit of the council's own tenants.
- The main features of the HRA are:
  - it is a landlord account, recording expenditure and income arising from the provision of housing accommodation by local housing authorities (under the powers and duties conferred on them in Part II of the Housing Act 1985 and certain provisions of earlier legislation);
  - it is not a separate fund but a ring-fenced account of certain defined transactions, relating to local authority housing, within the General Fund.
  - Credits and Debits are prescribed by statute.

- the main items of expenditure included in the account are management and maintenance (M&M) costs, major repairs, loan charges, and depreciation costs.
  - the main sources of income are from tenants in the form of rents and service charges.
  - the HRA should be based on accruals in accordance with proper accounting practices, rather than cash accounting
  - No general discretion to breach the ring-fence.
  - A Local Authority cannot budget for a deficit.
  - All borrowing within the HRA must be in line with the CIPFA Prudential Code.
- The Council must ensure the proper and lawful processes are followed to support the transitional arrangements, including but not limited to employment, contracts, company and commercial matters and tenancy transfer.

Beth Brown, Head of Legal and Governance, 25<sup>th</sup> April 2022

## 10 **Equality Impact Assessment (EIA)**

**10.1** Has the equality impact of the proposals in this report been assessed?

No ☒  
 An EIA is not required because:  
 There is no change to delivery of services.  
 (Please explain why an EIA is not necessary)  
 Yes ☐

## 11 **Data Protection Impact Assessment (DPIA)**

**11.1** Has the data protection impact of the proposals in this report been assessed?

No ☒  
 A DPIA is not required because:  
 No data is being processed at this point.

## 12 **Carbon Impact Assessment (CIA)**

**12.1** Has the carbon impact of the proposals in this report been assessed?

No ☒  
 A CIA is not required because:  
 No new policies are being proposed at this stage.

## 13 **List of background papers relied upon in writing this report (not including published documents or confidential or exempt information)**

1. Key Findings Report, Richard Penn (March 2022)
2. CIPFA HRA Review Phase 2 Consolidated Report

14 **Published documents referred to in this report**

- 14.1 Report to Extraordinary Council 4 January 2022 on unlawful use of HRA
- 14.2 Letter(s) from Minister Badenoch to Sir Tony Redmond on HRA Issue
- 14.3 Response from Sir Tony Redmond to Minister Badenoch on HRA issue

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# **Nottingham City Council**

## **Initial follow up independent investigation into officer and councillor actions, decision making and culture in response to the HRA Review undertaken by CIPFA**

### **Key Findings Report**

**Richard Penn**

**Independent Investigator**

**March 2022**

# 1 Background and methodology

I was commissioned in December 2021 through the Local Government Association, of which I am a Senior Associate, to conduct an initial and independent investigation following the Chartered Institute of Public Finance review into the Council's Housing Revenue Account (HRA) commissioned by the Interim s151s Officer, supported by the Chief Executive in consultation with the Leader of the Council. The CIPFA report concluded that the payments could reasonably be argued to be:

*'a mechanism conceived to divert HRA funds to the GF'*

and that if so, in CIPFA's view, this was:

*'an illegitimate use of HRA funds and a clear breach of the HRA ringfence which is potentially unlawful'.*

- 1.2 Subsequently, the s151 Officer's report concluded that illegitimate payments had been made from the HRA to the General Fund (GF) since 2014/15 and that payments made by NCH to NCC have been accounted for by NCC to the benefit of the GF rather than to the HRA. The Council commissioned advice from a leading QC who advised that the payments were unlawful and that the s114 Notice served by the Interim s151 Officer and the s5 Notice served by the Director of Legal and Governance were both appropriate and had underlined the serious way in which the Council was dealing with the issue.
- 1.3 I was commissioned by the City Council Chief Executive and this report on my investigation is for him for appropriate consideration and consequential action. I have regularly needed to make clear during my investigation that I am an independent consultant and that the LGA has had no involvement whatsoever in the investigation. My investigation has examined in detail the chronology of events in relation to the payments NCH made to NCC including who conceived the payments, who authorised them, the accounting transaction details, who knew about this, how challenges to the legitimacy of the payments were dealt with and by whom and any other facts that provide insight into how the situation came to be.
- 1.4 I was provided initially with a copy of the CIPFA review and other relevant documentation, but my investigation included a review of other documents in the public domain together with formal interviews with individuals both inside and outside the Council including representatives of Nottingham City Homes (NCH). I have interviewed 30 individuals including a number of current members of the Council, senior officers at the Council, the former Chief Executive, the former Director of Finance and the former Monitoring Officer, the Chair of NCH, the Chief Executive of NCH. Each person I interviewed was told that I would be taking a note of the key points that emerged from the discussion, and a draft record was then provided as a draft to each interviewee for comment and, if appropriate, correction. Agreed records of each interview were then finalised. I advised all of those that I interviewed that I would draw on the agreed record in compiling my report on the investigation.

- 1.5 I also received written submissions from a number of former Council employees including the former Chief Executive, a former Deputy s151 Officer, a former Strategic Director of Finance, the former Corporate Director Growth and City Development and a former Interim Chief Executive. The Chief Executive of NCH provided me with a comprehensive account of the events leading up to and subsequent to the initial payment from the HRA to the GF in 2014/15. I also met with the author of the CIPFA report and with the Chair of the Nottingham City Council Improvement and Assurance Board.

## 2 My investigation and findings

- 2.1 The payments made by NCH to NCC since 2014/5 resulted in the GF benefitting from these payments to a total of £15,858,500 in the period from 2014/15 to 2020/21. The CIPFA review concluded that these payments seemed to be a breach of the HRA ring-fence which is, potentially, unlawful. Furthermore, the Council has had confirmation from leading Counsel that the payments NCH has made to NCC are prohibited ‘*distributions of surpluses*’ and are unlawful. CIPFA had concluded that the payments could reasonably be argued to be:

*‘a mechanism conceived to divert HRA funds to the GF’*

and that if so, in CIPFA’s view, this is:

*‘an illegitimate use of HRA funds and a clear breach of the HRA ringfence which is potentially unlawful’.*

- 2.2 I was required through my investigation to examine in detail the chronology of events in relation to these payments and to answer four questions:

- *who conceived the payments, who authorised them and the accounting transaction details?*
- *who knew about the payments?*
- *how challenges to the legitimacy of the payments were dealt with and by whom*
- *and any other facts that may provide insight into how the situation came to be*

This investigation and the report will result in two important outcomes:

- the first outcome will be to inform the understanding of how and why the Council has arrived in this situation
- and the second outcome will be to demonstrate the seriousness of the Council’s intent to establish an organisational culture that has learning and accountability at its heart.

- 2.3 This Key Findings Report on my investigation and the findings, conclusions and recommendations set out in the Report are based on the detailed evidence that I gathered through my investigation.

### 3 The chronology of events

- in 2012 NCC and NCH began looking at efficiencies from joint working which could release ‘savings’. The Council’s budget setting for 2013/14 included ‘*Big Ticket*’ savings which did not include anything related to NCH’s budget setting for that year and it is understood that NCC delivered the 2013/14 saving through its own accountancy and management of the HRA.
- the Council then established an ‘*NCC and NCH Common Services Big Ticket Programme*’ and the payment had formed part of wider ‘*Big Ticket*’ savings from the HRA to the benefit of the GF.
- the payment from NCH to NCC was proposed the following year during the budget setting process for 2014/15, and was initially set at £750k based on ‘*efficiencies from improved joint working*’ between NCC and NCH and NCH that would deliver an HRA trading surplus.
- there was no serious challenge to the proposal at that time and assurance was given to anyone who questioned the proposal that it was ‘*legitimate*’ and allowable under the NCH Articles of Association and the Partnership Agreement.
- the repayment expected from NCH grew year on year at the direction of NCC to meet continuing GF shortfalls in budget setting, and these payments were no longer evidenced by efficiencies from ‘*joint working*’ or a ‘*trading surplus*’. Rather, NCH was required by NCC to make annual savings from its operating costs to deliver the increased return.
- NCH raised concerns in 2016 with senior NCC officers and councillors about the inappropriate use of HRA finances which were noted. An internal NCH email raised concerns over possible inappropriate use of the HRA when it reported that ‘*there is also a drive from some NCC officers to substitute HRA funding for GF funding of services.*’ NCH advised the City Council that the Communities and Local Government Department was taking a closer look at use of the HRA around the country, which led to the Big Ticket Programme Board asking for assurance about what was proposed.
- NCC continued to expect an annual increase in the return leading to the NCH Board formally stating its concerns at the Partnership Forum in 2017. The expected return increased again to reach £4.125m in 2018/19 despite the concerns raised by NCH officers and the NCH Board.
- in 2018 it was acknowledged that the level of return was unjustifiable and steps were put in place to significantly reduce the level of annual return in subsequent years
- in 2021 the NCC Interim s151 Officer, supported by the Chief Executive in consultation with the Leader of the Council, commissioned the CIPFA review.

- the CIPFA review concluded that however the payments made by NCH to NCC since 2014/5 are defined or described, the GF has benefited from these payments totalling £15,858,500 in the period from 2014/15 to 2020/21. This seemed to be a breach of the HRA ring-fence which is, potentially, unlawful. Furthermore, if it was determined, on the basis of legal advice, that the payments NCH had made to NCC were prohibited ‘distributions of surpluses’ these were also, potentially, unlawful.
- inter alia, CIPFA recommended that given the potentially serious implications for both NCC and NCH, NCC should commission legal advice on the issues of lawfulness and should examine in detail the chronology of events in relation to the budgeting for and payments NCH had made to NCC including who conceived the initial payment, who authorised it, the accounting transaction detail, who knew about it, how challenges to the legitimacy of the payment were dealt with and by who and any other facts that could provide insight into how the situation came to be.
- in December 2021 an independent investigation was commissioned by the NCC Chief Executive
- on 15 December 2021 the Council’s Interim s151 Officer served a s114 Notice on the Council relating to the treatment by the City Council of annual ‘*management fee rebates*’ from NCH since 2014/15 (funds derived from the Housing Revenue Account (HRA)) as General Fund (GF) income in breach of the HRA ‘Ring Fence’ under the Housing Act 1989 (S74) and the receipt by NCC since 2014/15 of annual ‘*management fee rebates*’ paid by NCH Limited (a wholly owned and controlled company of NCC), in breach of its Articles of Association. The Interim s151 Officer was not requiring the cessation of spending by NCC but rather bringing to members’ attention acts of unlawfulness. He imposed a management action prohibiting NCC entering into new agreements and spending commitments with NCH unless expressly approved in writing by himself in consultation with the Chief Executive and Monitoring Officer as appropriate.
- the same day the Council’s Monitoring Officer served a s5 Notice on the Council to report that he was satisfied that the relevant information had been brought to the attention of all members of the authority as required by s5 LGHA 1989, by virtue of the s114 report.
- the Council has received advice commissioned by the Interim s151 Officer and the Director of Legal and Governance from leading Counsel confirming that the payments were unlawful and that the s114 and s5 Notices were appropriate.
- in March 2022 this Key Findings Report on the independent investigation was submitted to the Council’s Chief Executive.

## 4 My findings

4.1 I was required by Nottingham City Council (NCC) through this investigation to examine in detail the chronology of events in relation to the payments that had been made from the Housing Revenue Account (HRA) to the General Fund (GF) since 2014/15 and then to answer four questions:

- *who conceived the payments, who authorised them and the accounting transaction details?*

The answer to this question is straightforward. In July 2013 indicative savings targets were allocated to each Corporate Director (in this case the then Corporate Director of Development) based on the budget share for their Directorate. The process for generating potential savings for the Council's 2014/15 budget against these targets consisted of a number of elements: traditional savings, income generation, increases in charges, and the '*Big Tickets*' exercise. The clear political directive was to find the savings from efficiencies before cuts in spending wherever possible. '*Big Tickets*' were ideas generated in Directorates through Working Groups of officers and councillors to find large-scale (over £1 million) savings. Proposers had to provide assurance of the robustness of the saving for it to be approved in the Council's budget process. Proposals were considered by the Leadership Group (the former Leader, the former Deputy Leader, the former Chief Executive and the former Deputy Chief Executive/s151 Officer) and then agreed at budget meetings with the Executive. Throughout the process, checks and balances were built in to allow for the robustness and deliverability of proposals to be assured before being presented to councillors. This included requiring sign-off from officers with relevant technical or finance knowledge/expertise. Sessions with the whole Executive allowed for a political '*lens*' to be applied to the savings proposals and open and robust discussions took place on each and every savings proposal. The item referred to as the '*HRA saving proposal*' in the CIPFA report was developed as part of the 2014/15 budget process during the autumn of 2013. This proposal was one of many that were made by the then Corporate Director of Development as a result of the '*Big Ticket*' initiative. There was a clear expectation that only robust and legitimate proposals would be fully considered, and that all proposals were legitimate and deliverable. No concerns were raised about the long-term viability of this Nottingham City Homes (NCH) '*Big Ticket*', and assurance was clearly given as to the viability and legitimacy of this saving from officers from the Finance team and those who managed the NCC relationship with NCH. As well as officers with the responsibility for managing the Housing functions, the s151 Officer, the Director of Finance and the HRA Finance expert were all sighted on the proposal and none of them raised concerns about its legitimacy. After the in-principle agreement to this proposal no further concerns were raised by officers later in the process, including the Monitoring Officer or any of the Legal team.

- *who knew about the payments?*

Again, the answer to this question is straightforward. All those at NCC and NCH who were involved in the NCH '*Big Ticket*' process were fully aware of this proposal, and those officers and members who were directly involved in finalising the 2014/15 revenue budget potentially

knew about it. It was no secret – at p. 257 of the Budget Report for 2014/15 under ‘*Joint working/cost saving initiatives*’ it was stated that:

*‘the City Council and NCH has embarked on a review of services to be delivered in partnership to deliver General Fund savings whilst ensuring that the HRA is charged a proportionate share of the costs. Page 256 Annex 4 – Appendix A17/02/2014 It is proposed elsewhere in this report that the City Council will require NCH to return a proportion of any surplus generated from trading activity (£0.750m in 2014/15). This proposal has no direct impact upon the HRA.’*

so anyone who had looked at the 2014/15 Budget report – and that presumably includes all members of the Council, senior Council officers, representatives of partner and stakeholder organisations, the Council’s external auditors as well as the local media and the Nottingham public – potentially could have been aware of this proposal at the time. The former Corporate Director of Development who sponsored the proposal has said that Finance and Legal officers were closely involved at all stages and the proposal had been deemed legitimate by the two statutory officers - the s151 Officer and the Monitoring Officer - at the time.

- *how challenges to the legitimacy of the payments were dealt with and by whom*

The evidence is clear that at the time of its conception the proposal was not challenged except by the Finance officer who managed the HRA. As time went on there were more concerns expressed by NCC councillors and a former NCC Director of Finance who were appointed to the NCH Board about what had become annual payments from NCC to the Council, but the concern was only about the increasing quantum of the payments and the detrimental impact on tenants and not about the principle of the payments or their lawfulness. The first formal challenge came from the newly appointed NCH Chair who in April 2017 wrote to the Deputy Leader and Portfolio Holder for Finance at the City Council to raise his concerns that the £3.625m return planned for that year was not based on any legitimate trading surplus and that there was a lack of transparency about what the HRA money was being used for by the City Council. His concerns were then dealt with at meetings of the NCC/NCH Partnership Forum. And that seems to have been the case – that it was finance officers who reassured anyone who queried the appropriateness or the legitimacy of the payments that everything was ‘*ok*’. The Council’s legal team was neither asked for nor offered advice about the lawfulness or otherwise of these payments. When the report of the CIPFA review concluded that these payments seemed to be a breach of the HRA ‘*ring-fence*’ which is, potentially, unlawful and that, if it is determined on the basis of legal advice, that the payments NCH has made to NCC are prohibited distributions of surpluses these are also potentially unlawful, this took everyone by surprise both at NCC and NCH as the focus of any concerns had been on the amounts of the payments not their lawfulness. I was not required as part of my investigation to determine whether the payments were or were not ‘*lawful*’ – in any case, as someone who is neither a solicitor nor an HRA finance expert this would not have been possible for me – but it has been interesting to discover that the legal advice obtained by NCC and the legal advice obtained by NCH is contradictory. The legal advice to NCH in summary was that:

1. the annual refund made to NCC was consistent with both the Partnership Agreement and the Articles of the Company
2. surpluses retained by NCH can be used in furtherance of any of its Objects
3. Board members had not breached any other fiduciary or statutory duties

whereas the legal advice to NCC has been in summary that the payments were in contravention of NCH's Articles of Association and the 2011 and 2020 Partnership Agreements between NCC and NCH. NCH's Articles prohibit the distribution by NCH of profit to NCC by way of a dividend, bonus or profit. There is a conflict between the Articles and the Partnership Agreements but the Articles prevail, and not only do the Articles take precedence over the Partnership Agreement and prohibit the return of surpluses to NCC, this is any event prohibited by the overriding legislative ring-fencing protecting the HRA and any such treatment constitutes an unlawful use of HRA money

- *and any other facts that may provide insight into how the situation came to be*

Based on this wide-ranging review of relevant documentation and meetings with the NCC senior officers and elected members involved with the decision to transfer '*surpluses*' from the HRA to the General Fund in the 2014/15 Council budget, the available evidence clearly indicates that this proposal originated from the former Corporate Director of Development (who had responsibility for housing in at the time) as part of his response to need to identify so called '*Big Ticket*' items that would reduce the need for savings that may have led to service cuts and/or job losses. Assurance was given by him and by the Finance staff involved to anyone who questioned whether this proposal was '*legitimate*', and when junior officers associated with the management of the HRA questioned this and other HRA '*adjustments*' that it was all ok, there was backing from the political leadership and not to '*rock the boat*'. The Finance team ran the budgeting process and no legal advice was either sought from or offered by the Council's legal team about the lawfulness of the proposal. Legal staff generally, and the Monitoring Officer at the time specifically, were not engaged with the '*Big Ticket*' process or in the meetings where these matters were being considered by elected members and decisions were being made in relation to the 2014/15 budget. The Monitoring Officer was entitled to attend CLT and the Executive Panel but did not always choose to do so.

- 4.2 Notwithstanding the nature of the HRA ring-fence and the wholly-owned company that had been established to deliver services through HRA funding, there was no evidence of professional or intellectual curiosity from NCC officers as to the ability to do this - to make payments from the HRA to contribute to GF savings - notwithstanding the increasing amounts required over the years. The performance of those senior NCC officers with responsibility for Housing and Finance at that time fell well below what could reasonably be expected in terms of knowledge of the law in relation to HRA ring fence and providing advice to councillors. The general view of those councillors involved appears to have been that the issue was either not raised as a concern, or alternatively assurance was provided by the former Corporate Director of Development and Finance officers that it was legitimate and appropriate. No contrition or apologies have been offered by those involved.

- 4.3 Any concerns on the part of NCH appear to have been mainly centred on the increasing quantum of the payments and the financial strain they were putting the company under, rather than putting steps in place to stop the payments being made because they were considered unlawful or inappropriate. At both NCC and NCH the prevailing attitude appears to have been ‘*go along to get along*’.
- 4.4 However, I have not concluded that the payments were initially ‘*a mechanism conceived to divert HRA funds to the GF*’ as suggested in the report of the CIPFA review. The evidence indicates that the payment in the 2014/15 budget process was an officer-driven proposal, not a political instruction, in an environment where there were many proposals to reduce expenditure or increase income in order to meet the political imperative to maintain services and avoid cutting jobs. However, the annual payment then continued and the amount of the payment differed from year to year as did the description of the payment, and this increases the likelihood that it did become an accepted mechanism to divert funds from the HRA to the GF. That this was allowed to happen and continued for so long was down to poor governance practice, principally at NCC but also at NCH. Senior officers at NCC responsible for the Housing, Finance and Legal functions were expected to understand the GF rules and law around the HRA ring-fence, and to enquire and to challenge robustly any proposals that could potentially breach the ring fence. Notwithstanding that the historic culture at the time was that challenge of members or speaking ‘*truth to power*’ was not welcomed, that is the role of senior professional officers and it is the responsibility of councillors to ask for and take any such advice into careful consideration in decision making.
- 4.5 There has also been a serious failure of governance at NCH where the NCH Chief Executive and others had a sufficient knowledge of the HRA ringfence to know that returning surpluses back to the Council to help with General Fund budget pressures could not be justified but they went along with it. Whilst NCH is a wholly owned NCC company the relationship does not appear to be one that reflects that ownership reality, with little evidence of NCC setting strategic priorities for NCH and of NCH delivering against those. Rather, the evidence shows a lack of accountability with NCH seeking to pursue its own agenda with very weak effective client management from NCC. This appears to have been allowed to happen as a result of the ‘*hollowing-out*’ of the strategic local housing authority function at NCC in the belief that large parts of this could be carried out by NCH. This has led to NCC being exposed to significant risk in terms of having little or no control over significant housing functions for which it is responsible. Put simply, the governance arrangements between NCC and NCH are not ‘*fit for purpose*’. Even though it is a wholly owned subsidiary, NCC does not have the right to appoint or remove the Chair, nor does it have the right to appoint or remove the Chief Executive. NCC will need to take steps to reduce the risk associated with the management of its council housing and the performance of its local housing authority function.
- 4.6 My investigation was expected to result in two important outcomes that:
- **the first outcome** would be to inform the understanding of how and why the Council has arrived in this situation. Based on the evidence that I have been able to gather the organisational environment in which these payments were conceived and authorised in 2013 -2014 was remarkably similar to the organisational environment described in the Rapid Review report seven years later. There was a ‘strong Leader’ model in operation at the time, and a number of former NCC senior managers that I met with commented on a

political and managerial leadership that had failed and was not capable of listening and acting. However, although the picture painted by this evidence could have led to the City Council acting inappropriately and potentially unlawfully in its decision to make annual payments since 2014/5 that resulted in the GF benefiting from these payments to a total of £15,858,500 in the period up to 2020/21, I have not concluded that the payments were ‘*a mechanism conceived to divert HRA funds to the GF*’ as suggested in the CIPFA Report.

- the Council has acted unlawfully and, furthermore, resources have been systematically taken away from some of its most vulnerable citizens – as by definition citizens need to demonstrate significant need to qualify for social housing in the first place. The Council has been undertaking a very significant recovery and improvement journey in the last year. However, on the evidence of the CIPFA Report and this investigation this is not the case with its wholly-owned company, NCH. Moreover, the overriding original rationale for establishing an ALMO, to access ‘*Decent Homes Funding*’ for the upgrading of council housing, no longer exists. The evidence shows clearly that the Council’s existing relationship with NCH is problematic, not ‘*fit for purpose*’ and adds risk and complexity to the Council in the delivery of its statutory obligations and policy priorities. The Council needs to be clear, purposeful and swift in its response. I have therefore recommended that urgent consideration is given to bringing back ‘*in house*’ the management of the Council’s housing stock and related functions. Ordinarily not less than 12 months’ notice would be required to achieve this to allow sufficient time for the necessary project planning and implementation to take place in relation to the TUPE of staff to the Council, where they will become council employees, and the necessary integration of financial and management systems. Between now and when the ‘*Notice to Terminate*’ is served, the Articles of Association, the rules governing how the company operates lodged at Companies House, need to be amended to give the Council the right to appoint and dismiss the Chair of the Board and the Chief Executive along with other changes to ensure that the Council has the necessary close control over the company. The Council’s Shareholder Unit function, supported by the Council’s Statutory Officers, will have far greater oversight over the operation of NCH and its subsidiaries. The Council is already significantly strengthening its local housing authority role, to include effective clienting arrangements of NCH. This should also include project planning for the return of council housing management to the Council.
- the second outcome** would be to demonstrate the seriousness of the Council’s intent to establish an organisational culture that has learning and accountability at its heart. This episode has of course been a disappointing setback for the Council on its improvement journey which has centred on improving strategic financial management and governance – poor examples of both have been identified through this investigation. Notwithstanding that, that the issue has been identified and dealt with by the Council itself, clearly demonstrates that the improvement journey is very much on track, and that there has been a sufficient shift in organisational culture that NCC senior officers have exposed the issue, spoken ‘*truth to power*’, and elected members have responded positively with a resolve to put things right as evidenced by the recommendations unanimously passed at the

Extraordinary Full Council meeting held on 4 January 2022. The Council knows full well what '*good*' looks like and has been determined to not put itself in the position of requiring the Improvement and Assurance Board or Commissioners to identify any wrongdoing and then put it right.

## 5 Recommendations

1. that, having regard to the CIPFA Review and this investigation, urgent consideration is given by the Council to bringing back '*in house*' the management of the Council's housing stock and related functions. Between now and when a 'Notice to Terminate' is served, the Council to expedite the significant strengthening of the governance arrangements applied to NCH, to ensure that the Council can demonstrate and exert the required control over NCH as a wholly owned Teckal company, to provide the necessary assurance over the management of the Housing Revenue Account. This should include amending the Articles of Association, the rules governing how the company operates lodged at Companies House, to give the Council the right to appoint and dismiss the Chair of the Board and the Chief Executive.
2. that the ongoing strengthening of the Council's local housing authority role, to include effective clienting arrangements of NCH, together with the undertaking of project planning for the return of council housing management to the Council, with the necessary resources being allocated.
3. that arrangements should be made for additional advice, guidance and support for the Council's Finance Team including external support.
4. that the Monitoring Officer and the s151 Officer should be formally and more actively involved along with the Chief Executive as the Council's third statutory officer in fulfilling their statutory responsibilities for the provision of advice to elected members on any proposed action by the Council that could potentially be unlawful.
5. that any such advice from the Council's three statutory officers must be fully respected by both members and officers and given due weight in the Council's decision making processes.
6. that the Council's external auditors should be required to have a greater focus on how the Council is taking decisions and responding to the advice from the Council's statutory officers rather than relying on '*materiality*' to trigger potential intervention.
7. that whilst the operating environment may have been considered challenging or difficult, the investigation has found that a number of former NCC officers fell below the standard that could reasonably be expected in showing the necessary intellectual curiosity, and providing clear advice about the inappropriateness of action by the Council in this regard. The Council should seriously consider passing details of the CIPFA Report and this Report to relevant professional bodies, where relevant professional qualifications were and are held, for those professional bodies to determine whether they wish to consider any support, guidance or action in this matter. This would be a serious step and proper consideration needs to be given to the relevant evidence before any such action is taken to avoid potential litigation.
8. that the Council's Constitution - including the various Codes of Conduct - should be critically reviewed to ensure that the lessons learned from this experience have been fully encapsulated in the requirements set out in the Council's Constitution.

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# Nottingham City Council: HRA Review Phase 2 – Workstreams A & B

Final Report

April 2022

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# 1. Executive Summary

## Introduction

This report is a follow up to our HRA Phase 1 report that identified illegitimate breaches of the HRA ring-fence (subsequently confirmed by legal Counsel to be unlawful), namely payments made by NCH to NCC that were incorrectly credited to the General Fund (GF).

In this Phase 2 report, we set out our findings in relation to our work in following up on two of the recommendations in our Phase 1 report in relation to:

- Workstream A - Transactions between the HRA and the GF and whether decisions taken in relation to these transactions undermine the integrity of the HRA ring-fence, in particular we have focused on issues brought to our attention during Phase 1
- Workstream B - The extent to which HRA monies have been spent on HRA activities by NCH between 2014-15 and 2020-21

## Workstream A

Our report on Workstream A is included as Part 1 of this report. In the production of this report we have examined information provided to us by NCC from both HRA and GF teams. The gathering of evidence has proven difficult. There is little or no “audit trail” (working papers, reports etc.) in relation to many of the issues considered and to support decisions that have been taken that impact on the HRA. This has necessitated both the use of estimates and extrapolation in order to arrive at an assessed financial position but in the absence of firm evidence, this is the only realistic approach.

## Overall Conclusions

It is apparent that, historically, decisions that impact on the HRA have been taken by NCC without full consideration of the HRA ring-fence and have been presented as a fait accompli to those responsible for administering the HRA and that the basis for decisions and the supporting documentation was either not retained or quite possibly never existed.

On the basis of the evidence that has been provided to us and conversations with NCC staff in relation to this evidence, we conclude that a number of decisions have been taken that do not appear to be justifiable and appear to undermine the HRA ring-fence. In particular:

- Loss of income to the HRA on Manvers Street Car Park (£295,000)

- Cessation of Rebate in relation to RTB in relation to Public Realm Charges (£5,272,050)
- Introduction of a charge to the HRA in relation to Pest Control (£80,000)
- Charges in relation to Street Lighting (£2,272,420)
- Contribution from the HRA to the GF regarding Solar (PV) Panels (£400,000)
- Cessation of an HRA charge to the GF regarding the Housing Partnership Team (£183,560).

In total, the above items amount to **£8,503,030**. However, it should be noted that these amounts are based on historic values which may well have changed since the relevant decisions were taken.

In addition to the above there are other issues that we have examined where a firm conclusion cannot be made on the fairness of the charges made to the HRA since there is no clear basis or SLA on which these charges are based. In particular we would draw attention to the £500,000 charge that was introduced in 2019-20 for Corporate and Democratic Core. Whilst such a charge is common, no evidence has been provided to support the amount of this new charge.

There has been some work on developing SLAs undertaken (with NCH) but they do not seem to have the level of detail necessary to be a sound basis for calculating charges to the HRA and have not been finalised.

As we comment on a number of times in this report, it is essential that the amount and basis of all charges to the HRA can be properly justified in order to ensure the integrity of the HRA ring-fence.

## **Recommendations**

We recommend that NCC considers our conclusions in relation to each of the items that combined have a value of £8,503,030 and determines:

- The amount the HRA should be reimbursed (taking into account any interest that might have accrued on the sums to be paid to the HRA)
- Any adjustments that might be necessary to reflect these amounts are based on historic values which may well have changed since the relevant decisions were taken.
- The actions needed to rectify these items from 2022-23 onwards.

We also recommend that work should be undertaken in relation to all charges to the HRA from the GF to provide a sound basis for the calculation of such charges combined with SLAs that have sufficient granularity to support these charges and any changes over time.

Finally, we recommend it should be mandatory that appropriate NCC staff with sufficient knowledge of the HRA ring-fence should be consulted before any decision impacting on the HRA is taken; ideally there should be an HRA “champion” who would need to agree to such decisions once satisfied such decisions do not breach the HRA ring-fence.

## Workstream B

Our report on Workstream B is included as Part 2 of this report.

### Key Findings

- (a) **The funding from the ring-fenced HRA account received by NCH between 2014-15 and 2020-21 exceeded its spending on HRA activities.** Cumulative funding reached £417,800,920 by the end of 2020-21, whereas cumulative expenditure was £386,275,804. As a consequence, funding has exceeded expenditure by £31,525,117.
- (b) **The scale of the gap does not take into account the annual payments made by NCH that NCC credited to the GF.** On the assumption that the £14,366,500 returned to the HRA, there remains a difference of £17,158,617 between HRA funding and HRA expenditure from 2014-15 to 2020-21.
- (c) **The capacity for NCH to remedy this gap is constrained.** The cash balance of £15,673,588 at 31 March 2021 was essentially due to the net receipt of £22,759,590 in loans from NCC in 2020-21 for non-HRA projects. Whilst this cash inflow was to replenish NCH resources previously invested in non-HRA activities, the likely earlier utilisation of HRA funds on such non-HRA investments and the subsequent replenishment with non-HRA funds requires a formal direction from the Department for Levelling Up, Homes and Communities.
- (d) **Furthermore, we have not seen any evidence that NCH has the appetite to ring-fence HRA funding and expenditure from its non-HRA activities.** Interviewees have emphasised that NCC has not placed any obligation on it to ring-fence HRA activities. Whilst some interviewees recognised a possible expectation that they should ring-fence HRA activities in future, we are not aware of how NCH has responded to NCC’s written notification of the need to do so.

- (e) **The ledgers kept by NCH do not differentiate between HRA and non-HRA activities.** NCH was unable to produce a statement that summarised income received from the HRA and how it was utilised for each year between 2014-15 and 2020-21. Furthermore, NCH only maintained one ledger covering all of the activities and transactions of NCH **and** its subsidiaries in 2020-21, although this has since changed.

The consolidated financial statements for the group, and the financial statements for Nottingham City Homes Enterprises Ltd (NCHEL) and Nottingham City Homes Registered Provider Ltd (NCHRP) were dependent on a series of spreadsheet adjustments made at year end. The basis for the adjustments could not be readily explained or evidenced which in turn, complicates the process of demonstrating that the financial accounts comply with company law. Re-structuring account codes to differentiate between HRA and non-HRA activities, and maintaining different ledgers for each company within the group are critical and will require additional finance resources. This is required not only to enable HRA and non-HRA activities to be kept apart, but to mitigate the current reliance on one individual to explain the rationale of the existing working papers for the financial statements.

- (f) **Separating HRA funding and expenditure within NCH has proved very difficult.** There is no direct linkage between the HRA funding received and how it has been utilised. As interviewees commented, all revenue funding received from NCC (HRA or General Fund), is treated as one income source. The main HRA revenue funding - the management fees and the maintenance and repairs fees are assigned to one account code and we have not found any journals or other papers to show how this aligns with the account codes used to record expenditure. In comparison, capital fees and works are assigned to specific cost centres. We have not been able to confirm with both parties that the funding from NCC recorded in NCH ledgers, aligns with the figures in NCC's records.
- (g) **The difficulties in identifying how HRA funds have been utilised are compounded by out-dated recharges between account codes that we could not validate.** NCH are determining the costs of maintenance and repair works and capital works on non-HRA properties based on a schedule of rates that cannot be validated. The rates are bespoke to NCH, and there is no record of how they were compiled. Furthermore, the non-HRA costs recovered from NCH's

subsidiaries are based on assumed costs per property rather than actuals and we have not been able to establish the basis of the estimates for overheads. This presents a strong likelihood that non-HRA subsidiaries could be subsidised with HRA funds which would be an illegitimate use of HRA monies.

- (h) **We have not been able to adequately confirm the number of properties managed on behalf of the Council as specified in NCH's financial statements for 2020-21.** Regular reconciliations are not undertaken and there is a discrepancy of 65 properties that has not yet been resolved.

## Overall Conclusions

In our opinion, the duty on NCC to ensure that HRA monies are only spent to the benefit of HRA tenants does not cease when it delegates the service provision to an arms-length management organisation. On the basis of our analysis, the failure to require its arms-length management organisation (NCH) to maintain this ring-fence for its operations means that, in addition to the £14,366,500 payments to the NCC General Fund that need to be remedied, a further £17,158,617 of HRA funds between 2014-15 and 2020-21 were not utilised by NCH on HRA activities by 31 March 2021. This estimate is based on the assumption that NCC funding reconciles with the records held by NCH.

## Recommendations

NCC should, as a matter of priority, revise existing funding agreements with NCH to specify an obligation to ring-fence HRA activities. This should include the production of an annual statement that shows the funding received and how it has been utilised. This will necessitate changes in the accounting ledger(s) within NCH and is likely to require additional finance resources in order to make the change and to maintain future accounting records.

Having established the extent of HRA funding that has not been utilised for HRA activities, the Council will need to determine whether NCH has the capacity to remedy this matter without financial support. On the basis that the cash balance at 31 March 2021 largely comprised General Fund loans from NCC that replenish the highly likely utilisation of HRA cash surpluses to forward fund non-HRA investments, any such support would need to be approved by the Department for Levelling Up, Homes and Communities.

Alongside the actions to introduce an HRA ring-fence, the basis of costings and recharges for work done by NCH and its subsidiaries needs to be updated. The onus should be on actuals rather than estimates. For example, the schedule of rates is no longer fit for purpose

and the cost of work done by the Construction Repairs and Maintenance team should be based on the materials and labour costs incurred, plus an overhead rate based on all indirect costs within the organisation. A similar approach should be used for all other services provided to subsidiaries and other organisations.

## Part A: Workstream A Report

## 2. Introduction

### Background

The focus of Phase 1 was the nature of the payments made by Nottingham City Homes (NCH) to NCC since 2014-15. NCC is dealing with the conclusions drawn in relation to this series of payments and the consequences for NCC and NCH.

In addition, however, the Phase 1 report identified the potential for further breaches of the HRA ring-fence in two specific areas which will be the focus of the Phase 2 work.

The Phase 1 report states, in Section 8, in relation to potential breaches of the HRA ring-fence within NCC:

#### **Potential Breaches of the HRA ring-fence**

It has been suggested to us decisions have been taken by NCC that could be challenged as having undermined the integrity of the HRA ring-fence. These decisions fall into two key categories:

- Decisions that have resulted in a loss of income to the HRA to the benefit of the GF;
- Decisions that have resulted in the HRA bearing disproportionate costs to the benefit of the GF.

An example of the former is a car park on HRA land for which it receives no income, the income going to the GF. We understand this has been the case for at least a decade.

An example of the latter is cessation of a rebate on the cost of public realm (including grounds maintenance, street lighting, and street cleaning) charged to the HRA by the GF to reflect Right to Buy (RTB) properties on council estates.

We have been provided with a schedule of more than a dozen such issues which will require further investigation. NCH is not party to these potential breaches of the HRA ring-fence.

The examination of the issues raised during our Phase 1 work are the subject of this Phase 2: Workstream A Report.

## Work undertaken

In the production of this report we have examined information provided to us by NCC from both HRA and GF teams. The gathering of evidence has proven difficult. There is little or no “audit trail” (working papers, reports etc.) in relation to many of the issues considered and to support decisions that have been taken that impact on the HRA.

This is despite great effort on the part of the NCC staff consulted in the course of our work though the lack of evidence has been exacerbated by the apparent lack of capacity within NCC Finance teams.

However, on the basis of the evidence that has been provided to us and conversations with NCC staff, this report sets out our conclusions (where possible) on the issues raised in Phase 1 of our work. Inevitably, we also identify further work that needs to be done to ensure that the HRA ring-fence is maintained.

In examining the issues raised, we have taken into account the MHCLG’s 2020 guidance on Operation of the HRA ring-fence (Annex A) together, where appropriate with any earlier guidance in relation to the HRA (namely Circular 8/95).

In this report we have grouped the issues by service area:

- Section 3: Resident Services
- Section 4: Finance and Resources
- Section 5: Development and Growth

## 3. Resident Services

### Overview

This section covers issues raised in relation to:

- Manvers Street (Sneinton) Car Park
- Public Realm (including Pest Control)
- CCTV
- Community Protection (Antisocial Behaviour)

### Manvers Street (Sneinton) Car Park

We were originally informed that this issue related to Sneinton car park but have now been told it relates to Manvers Street car park which is adjacent to a block of flats and is on HRA land.

Up to and including the financial year 2008/09 the HRA received the income from this car park. In 2008/09 the income received was £21,880. Our understanding is that since then the income has been retained in the GF. We are told that when the HRA tried to reclaim this income in 2017-18, the response was that the income was now part of the GF budgets and would not be paid to the HRA. Current Parking Services staff inherited the current arrangement.

In the period 2014-15 to 2020-21, actual income in relation to Manvers Street car park has totalled £159,058.20 (an average of £22,722.60). We do not have data relating to income in the five year period 2009-10 to 2013-14 or for 2021-22.

It appears that the cessation of payment of income from the Manvers Street car park in 2009/10 was an “administrative” oversight that has continued, even when it was brought to attention in 2017-18.

There is, understandably, no reference to car parks in the 2020 guidance since the operation of a public car park is not an HRA function. However, Circular 8/95 does refer to garages (and garage sites) let to non-housing revenue account tenants and states:

“Where an authority has a policy of letting, on a long-term basis, blocks of housing revenue account garages to people who are not housing revenue account tenants, the authority should consider appropriating the garages from Part II of the 1985 Act and accounting for them in the General Fund. The Department considers that, where tenants do not have the opportunity to rent the garages in a block, the provision of those garages does not form part of an authority’s housing function.”

Applying this principle, it seems that appropriation of the Manvers Street car park is the appropriate action to take going forward. However, until that is done, given the car park remains an HRA asset, it also seems appropriate that income from the car park is paid to the HRA, including any sums not paid in the past.

For the years for which data has been provided (including 2008-09), the average is £22,617.27. Applying this average for the years for which we do not have data, including the financial year just ended, the total income lost to the HRA is approximately £295,000. However, to confirm this figure, data for the missing years (2009-10 to 2013-14) will need to be obtained and income in 2021-22 identified.

## Public Realm

Public Realm is responsible for a significant proportion of the charges made to the HRA by the GF. We have received data from both HRA Finance and GF Finance in relation to Public Realm Charges which do not reconcile. These are set out below (provided by HRA Finance):

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
<b>Tree/horticultural Services</b>	516,160	520,550	527,600	527,600	527,600	527,600	537,465
<b>Grounds Maintenance</b>	1,900,640	1,900,000	1,900,700	1,900,000	1,900,000	2,200,000	2,241,829
<b>Street Lighting</b>	279,960	282,340	285,020	285,020	285,020	285,020	285,020
<b>Pest Control</b>	-	-	-	-	-	-	40,000
<b>Total</b>	<b>2,696,760</b>	<b>2,702,890</b>	<b>2,713,320</b>	<b>2,712,620</b>	<b>2,712,620</b>	<b>3,012,620</b>	<b>3,104,314</b>

A number of issues were raised with us in relation to the above charges:

- In the past, the HRA received a substantial rebate, we are given to understand to reflect the number of RTB properties on Council (HRA) estates, but this was reduced in 2016/17 and disappeared completely in 2017/18
- The charge to the HRA was increased by £300,000 in 2019/20 for “Enhanced Grounds Maintenance” but no additional service has been provided
- A charge was introduced in 2020-21 to the HRA in respect of service recipients of Pest Control who are HRA tenants. In 2020/21 this amounted to £40,000.

In the course of our work, another issue in relation to Public Realm charges became apparent, namely the charge in relation to Street Lighting.

## Rebate

In relation to the Rebate that was reduced and then disappeared, we have been provided with evidence by GF Finance of decisions taken to reduce and then eliminate this Rebate taken in Executive Board meetings to consider the MTFP.

- In relation to the MTFP 2016/17 to 2019/20 a recurring GF saving of £500,000 from 2016/17 is described as “Review of options and Housing Revenue Account considerations”
- In the MTFP 2017/18 to 2020/21 a recurring GF saving of £460,000 from 2017/18 is described as “Change in charges to Housing Revenue Account for shared services”

Despite effort to locate further evidence to explain and support the decisions made by the Executive Board, no further evidence has been found. In addition, evidence of how the Rebate was calculated has not been found.

Data provided by HRA Finance indicates the actual Rebate was:

- 2014-15: £935,300
- 2015-16: £943,250
- 2016-17: £454,410

These figures reflect the decisions taken by the Executive Board and also indicate that between 2014-15 and 2015-16 the Rebate increased, suggesting there was a basis on which it was calculated.

It seems reasonable that such a Rebate, to reflect RTB sales, should exist. Consequently it is hard to justify the reduction and subsequent elimination of the Rebate.

To the end of 2021-22, the lost Rebate amounts to £5,272,050. However, it should be noted that the Rebate if it has been in continuous payment may well have increased over time should it have been based on RTB sales which, it is assumed, have increased since 2015-16.

### **Increase in Grounds Maintenance Charge**

The table above demonstrates the annual increase of £300,000 in 2019/20. It has been suggested to us that this increase was to reflect increased costs rather than the provision of an “enhanced service”.

We have had sight of a draft SLA which indicates a proposed charge in 2022/23 of £2,727,600 (£2,200,000 for Streetscene and £527,600 for Parks and Open Spaces). This equates to the charges made in 2019-20 though is less than the charge in 2020-21.

This SLA is between NCC and NCH and, we are told, is under review. However, the SLA does not give any breakdown of the costs of specific activities or how the proposed costs are arrived at.

We have been told the cost of the services is not part of the SLA review but it is acknowledged that a wholesale review of the assets and the specifications for their maintenance needs to be carried out. This has been identified as a project, although not yet incepted. This work needs to be finalised so there is a clear and justifiable basis for the sum charged to the HRA.

### **Pest Control**

We understand this GF funded service does not charge certain service recipients (e.g. if on benefits) but, since 2020/21, a charge is made to the HRA in respect of service recipients or are HRA tenants. In 2020/21 this amounted to £40,000. We understand those responsible for the HRA were not consulted on or involved in this decision but, instead, presented with a fait accompli.

The evidence we have been provided for this states that “The majority of NCH tenants would be in receipt of Council tax benefit and would therefore qualify for free pest control treatment, rather than being charged by the Pest Control service. In addition, any aborted visits (pest operative attends but cannot gain access to the residence) result in operational costs which currently have to be absorbed by the Pest Control service. This charge of £40k is to cover the costs of the tenants who receive a service free of charge”. The evidence provided also states the proposed charge in 2021-22 and in 2022-23 will be £40,000.

The fact it is a flat charge suggests it is not directly related to the number of HRA tenants who might qualify for free pest control treatment. The basis of how the sum of £40,000 was arrived at has not been evidenced.

In any case, in our opinion, given this is a GF service and it is Council policy to provide the service free of charge to people receiving benefits, it does not seem appropriate to differentiate between the people who are eligible for free pest control treatment based on the basis of their tenancy/ownership. The value of the charge to the HRA in 2020-21 and 2021-22 totals £80,000.

### **Street Lighting**

As mentioned above, this issue came to light in the course of our work. The 2020 guidance includes Street Lighting in Non-Core Services. The guidance states “It is the view of MHCLG that it is inappropriate to assume that these services will be wholly charged to the HRA. Their costs should be met from the General Fund”

The total amount charged to the HRA between 2014-15 and 2020-21 is £1,987,400. Assuming the charge in 2021-22 remained the same as it has since 2016-17 (£285,020) the total amount at the end of 2021-22 would be £2,272,420.

## CCTV

There is an historic charge to the HRA in respect of CCTV. Between 2014-15 and 2019-20 the annual charge was £1,358,000. In 2020-21 this increased to £1,380,848 and in 2021-22 it increased to £1,459,713.

The issue raised with us is that the basis of the charge is unclear and that there is no SLA in place. Given the amount of the charge remained unchanged for six years, it would suggest there was no real basis for calculating the charge other than, perhaps some historic basis. It has, however, increased in the last two years.

We have been provided with some details of a proposed SLA (with NCH) dated August 2020 by the GF Finance Business Partner but this could not be reconciled back to the charges made and was unsure whether this was the final version.

CCTV is recognised as a Core Service in the 2020 guidance. However, as with all charges to the HRA there should be a clear and justifiable basis for the sum charged to the HRA. Clearly, some work has been done to regularise the basis and sum charged to the HRA in relation to CCTV. This needs to be finalised.

## Community Protection (Antisocial Behaviour)

There is an historic charge to the HRA. In 2014-15 this was £267,768. Between 2015-16 and 2019-20 the annual charge was £261,890. In 2020-21 and 2021-22 the annual charge increased to £287,890.

The issue raised with us is that the basis of the charge is unclear and that there is no SLA in place. Similar to the charge in relation to CCTV (above), the amount of the charge remained unchanged for some years (five years) but has increased in the last two years.

We have been provided with some details of a proposed SLA (with NCH) dated August 2020 by the GF Finance Business Partner but this could not be reconciled back to the charges made and was unsure whether this was the final version.

We have been provided with some details of a draft/unsigned SLA (with NCH) which does refer to the sum of £287,890 in 2020-21. However, the details provided to us do not set out how this sum is arrived at.

Antisocial behaviour is recognised as a Core Plus service in the 2020 guidance which states “Where the service is entirely charged to the General Fund it may be appropriate for the HRA to contribute to these costs”.

However, as with CCTV, there should be a clear and justifiable basis for the sum charged to the HRA. Clearly, some work has been done to regularise the basis and sum charged to the HRA in relation to the Community Protection charge. This needs to be finalised.

## 4. Finance and Resources

### Overview

This section covers issues raised in relation to:

- Solar (PV) Panels
- Corporate and Democratic Core
- Welfare Rights
- Support Services
- Debt Charges on Arboretum Properties

### Solar (PV) Panels

Solar (PV) Panels are located on HRA properties. We understand that investment in Solar (PV) Panels was undertaken in two phases. The Senior Accountant (Capital Programmes) has provided us with information in relation to this investment, which is set out below:

- Investment in the first phase was in the period 2011-12 to 2013-14 and amounted to £8.542m. The 2011-12 and 2012-13 spend (£8.578m) was funded by HRA supported borrowing. It is assumed the 2013/14 spend (£0.004m) was funded by revenue contribution
- Investment in the second phase took place in 2015-16 to 2016-17 and amounted to £3.398m. As projects were not funded on a scheme by scheme basis during that period and as no grant was available it is assumed that this phase was funded by HRA Capital Receipts.

The HRA has received income since 2012-13 (presumably in relation to the first phase of investment). This amounts to a total of £12.967m up to and including 2021-22.

In addition, we understand the GF makes an annual payment of £0.216m over 20 years (totalling £4.320m) to the HRA due to the HRA funding the project. In this regard, the GF carries the risk/reward and receives the FIT income (net of repayment to HRA.) We have not been provided with details of the income received by the GF.

The particular issue raised in relation to Solar (PV) Panels is a contribution from the HRA to the GF based, we are told, on improving collection rates of FiT. However, we are also told that NCH has not delivered improved levels of collection so, the opinion expressed to us (when the issue was raised) is that this contribution is hard to justify. This contribution (from the HRA to the GF) was introduced in 2020-21 and amounted to £200,000. The same amount was budgeted for 2021-22 bringing the total to the end of 2021-22 to £400,000.

Given the streams of income from the first and second phases are delineated between the HRA (first phase) and the GF (second phase) and that the HRA is recompensed for the HRA investment in the second phase (though the annual payment made by the GF to the HRA) it seems hard to justify any additional contribution from the HRA to the GF. Even if such a contribution could be justified, it appears to us, it could not be a set amount if it is related to improved levels of collection.

Consequently, in our opinion, there is a case for recompensing the HRA for contributions in 2020-21 and 2021-22 which (if the budgeted amount on 2021-22 has been made) amounts to £400,000.

## Corporate and Democratic Core

A charge in respect of Corporate and Democratic Core (Cost Centre 8900 - Corporate Management) to the HRA of £500,000 was introduced in 2019-20. The same charge was paid in 2020-21 and was budgeted for 2021-22.

We have not been provided with any evidence in relation to the basis of this charge or the reason for its introduction in 2019-20. Whilst, it may be considered acceptable for the HRA to bear a fair charge in relation to Corporate and Democratic Core (Corporate Management) it is essential that the amount and basis of such a charge to the HRA can be properly justified.

In the absence of such justification of the amount charged to the HRA, we are not in a position to comment on the fairness of this charge.

## Welfare Rights

There is an historic charge to the HRA in respect of Welfare Rights. This charge has been in the sum of £283,200 since 2016-17 (in 2014-15 it was £282,762 and in 2015-16 it was £280,530) and was budgeted to be £283,200 in 2021-22.

The issue raised with us is that the basis of the charge is unclear and that there is no SLA in place. We have not been provided with any evidence in relation to the basis of this charge or the nature of the services provided to the HRA. However, given the amount the charge has remained unchanged since 2016-17, this would suggest there is no real basis (at least not currently) on which this charge is calculated.

It is essential that the amount and basis of such a charge to the HRA can be properly justified. In the absence of such justification of the amount charged to the HRA, we are not in a position to comment on the fairness of this charge.

## Support Services

There are historic charges to the HRA for Support Services. The issue raised with us is that the basis of the charge is unclear and that there are no SLAs in place. The components of these charges and the annual sum since 2014/15 (provided by HRA Finance) are set out below:

Support Service Charges	Full Year Actual 2014-15	Full Year Actual 2015-16	Full Year Actual 2016-17	Full Year Actual 2017-18	Full Year Actual 2018-19	Full Year Actual 2019-20	Full Year Actual 2020-21	
Property Services-Ext	92,311	80,067	63,789	68,079	66,630	76,530	83,802	HRA Shops - time recharges
Recharge OT salary for Adaptations	16,685	17,548	18,112	17,575	17,083	18,853	20,040	1 post
Performance Management & Major Projects recharges	121,222	69,740	44,125	57,864	57,496	59,004	58,284	Variable - contribution to team cost
Property Services-Ext	51,767	40,617	53,283	0	0	0	0	Replaced by time charges
Finance Recharges	310,010	352,739	352,205	355,739	355,739	359,114	355,739	Includes Audit & Fraud in 19-20 (£3,375), not charged last year
EMSS Recharges External	73,360	11,753	11,735	11,853	11,853	11,853	11,853	
EMSS Recharges External	6,480	7,257	7,244	7,317	7,317	7,317	7,317	
IT Recharges External	143,200	152,582	154,950	154,950	154,950	156,500	130,760	Includes Switchboard recharge - missing in 20-21
Human Resources External	81,530	118,768	133,548	119,778	134,778	134,778	134,778	
Legal charges (Regen)	43,360	53,599	53,522	54,059	100,059	109,059	109,059	
Directorate Charge for time on HRA	23,380	23,380	23,610	23,380	23,380	23,380	23,380	
Finance Recharges	233,860	263,109	262,713	265,349	265,349	268,724	265,349	Includes Audit & Fraud in 19-20 (£3,375), not charged last year
EMSS Recharges External	0	8,767	8,749	8,837	8,837	8,837	8,837	
EMSS Recharges External	0	5,413	5,409	5,463	5,463	5,463	5,463	
IT Recharges External	108,030	114,008	111,640	111,640	111,640	114,008	93,400	Includes Switchboard recharge - missing in 20-21
Human Resources External	61,490	88,590	88,453	89,340	89,340	89,340	89,340	
Legal Services External	32,710	39,979	39,919	40,319	40,319	40,319	40,319	
Bank charges (from GF)	55,360	58,965	53,482	45,604	40,882	46,182	35,416	
Audit fees	3400	3400	0	0	0	0	0	Included in Finance Recharge
	<b>1,458,155</b>	<b>1,510,281</b>	<b>1,486,488</b>	<b>1,437,146</b>	<b>1,491,115</b>	<b>1,529,261</b>	<b>1,473,136</b>	

We have not been provided with any evidence in relation to the basis of these charges. As we have previously commented, it is essential that the amount and basis of such charges to the HRA can be properly justified. In the absence of such justification of the amounts charged to the HRA, we are not in a position to comment on the fairness of these charges.

## Debt Charges on Arboretum Properties

HRA properties (in relation to the Arboretum) were sold to NCH but the capital receipt was transferred to the General Fund. This amounted to £1,608,500 in 2019/20 and was referred to in our Phase 1 report.

The issue raised with us is whether there was any debt outstanding on these former HRA properties and, consequently, whether the HRA is still being charged in relation to any outstanding debt on these properties.

We have been told by the Senior Accountant (Capital Programmes) that the properties in question at the Arboretum were historic housing stock and that there are, consequently, no associated debt charges borne by the HRA.

## 5. Development and Growth

### Housing Partnership Team

There was formerly a recharge from the HRA to the GF in recognition that the Housing Partnership Team also work on GF activities (i.e. the private rented sector).

In 2015-16 and 2016-17 this was £45,500. In 2017-18 it was £45,890. Since 2018-19, there has been no charge and to the end of 2021-22, this would represent a loss to the HRA of £183,560.

We are told that this was presented as a fait accompli and it is not known how it was calculated before it was removed. No further evidence for the cessation of this charge from the HRA to the GF has been provided.

It is recognised that the Housing Partnerships Team does undertake GF activities so the cessation of the charge from the HRA to the GF is difficult to justify. Moreover, it has been questioned whether the sum should be higher although this would also need to be evidenced.

The amount should be reviewed and updated to cover a realistic proportion of the cost of staff that work on GF activities and reinstated. Alternatively, if possible, the costs should be split into HRA and GF cost centres.

It has also been suggested that the same approach should also apply to the Regeneration Team, who work on housing regeneration projects (not just HRA housing). This should equally apply to any income generated by the Regeneration Team.

In 2021-22 the net budget and FTEs associated with these teams was:

	Net budget 21/22	FTE
Regeneration	£1.979m	13.3
Housing Partnerships	£0.998m	8

## 6. Conclusions and Recommendations

### Overall Conclusions

We have considered the issues raised with us during the course of our Phase 1 work in this report. In Section 1 we comment on the difficulties encountered in finding evidence to support decisions that have been taken by NCC that impact on the HRA.

It is also apparent that, historically, decisions that impact on the HRA have been taken by NCC without full consideration of the HRA ring-fence and have been presented as a fait accompli to those responsible for administering the HRA.

On the basis of the evidence that has been provided to us and conversations with NCC staff in relation to this evidence, we do conclude that a number of decisions have been taken that cannot be justified and appear to undermine the HRA ring-fence. In particular:

- Loss of income to the HRA on Manvers Street Car Park (£295,000)
- Cessation of Rebate in relation to RTB in relation to Public Realm Charges (£5,272,050)
- Introduction of a charge to the HRA in relation to Pest Control (£80,000)
- Charges in relation to Street Lighting (£2,272,420)
- Contribution from the HRA to the GF regarding Solar (PV) Panels (£400,000)
- Cessation of an HRA charge to the GF regarding the Housing Partnership Team (£183,560).

In total, the above items amount to £8,503,030. However, it should be noted that these amounts are based on historic values which may well have changed since the relevant decisions were taken.

In addition to the above there are other issues that we have examined where a firm conclusion cannot be made on the fairness of the charges made to the HRA since there is no clear basis or SLA on which these charges are based. In particular we would draw attention to the £500,000 charge that was introduced in 2019-20 for Corporate and Democratic Core. No evidence has been provided to support this new charge.

There has been some work on developing SLAs undertaken (with NCH) but they do not seem to have the level of detail necessary to be a sound basis for calculating charges to the HRA and have not been finalised.

As we have commented a number of times in this report, it is essential that the amount and basis of all charges to the HRA can be properly justified in order to ensure the integrity of the HRA ring-fence.

## Recommendations

We recommend that NCC considers our conclusions in relation to each of the items that combined have a value of £8,503,030 and determines:

- The amount the HRA should be reimbursed (taking into account any interest that might have accrued on the sums to be paid to the HRA)
- Any adjustments that might be necessary to reflect these amounts are based on historic values which may well have changed since the relevant decisions were taken.
- The actions needed to rectify these items from 2022-23 onwards.

We also recommend that work should be undertaken in relation to all charges to the HRA from the GF to provide a sound basis for the calculation of such charges combined with SLAs that have sufficient granularity to support these charges and any changes over time.

Finally, we recommend it should be mandatory that appropriate NCC staff with sufficient knowledge of the HRA ring-fence should be consulted before any decision impacting on the HRA is taken; ideally there should be an HRA “champion” who would need to agree to such decisions once satisfied such decisions do not breach the HRA ring-fence.

# Annex A: Guidance – Operation of the Housing Revenue Account ring-fence

Published: 10 November 2020). Source: [www.gov.uk](http://www.gov.uk)

## 1. Introduction

This guidance updates and replaces Circular 8/95 published by the former Department of the Environment (DoE), to which the Ministry of Housing, Communities and Local Government (MHCLG) is a successor. It gives advice to local housing authorities in England on certain aspects of the Housing Revenue Account (“the HRA”).

DoE Circular 8/95 provided valuable advice and gave clarification of whether various items of expenditure and income should be accounted for inside or outside the HRA. However, circumstances have changed: estates are not necessarily purely council-owned and an increasing proportion of those living on these estates are no longer tenants of the council.

This guidance restates ministers’ established policy for the HRA and introduces no new issues of principle. However, it does highlight the need to be fair to both tenants and council taxpayers and that there should be a fair and transparent apportionment of costs between the HRA and General Fund.

This guidance is intended to be a helpful reference document for authorities, tenants and auditors. This guidance is not intended as an authoritative statement of the law on the keeping of the HRA, and authorities should take their own legal and accounting advice, as necessary, and will need to satisfy their auditors about their decisions.

## 2. Statutory background

Expenditure and income relating to property listed in section 74 of the Local Government and Housing Act 1989 (“the 1989 Act”) must be accounted for in the HRA. This comprises mostly housing and other property provided by authorities under Part II of the Housing Act 1985 (“the 1985 Act”).

Schedule 4 to the 1989 Act (as amended by section 127 of the Leasehold Reform, Housing and Urban Development Act 1993) specifies the debit and credit items to be recorded in the HRA. The Housing (Welfare Services) Order 1994 specifies the welfare services which must be accounted for outside the HRA.

### 3. General principles

The statutory provisions referred to above reflect the government's policy that the HRA remains a ring-fenced account within the General Fund; it should still be primarily a landlord account containing the income and expenditure arising from a housing authority's landlord functions.

#### Property in the HRA

At its most basic, when taking any decision on whether expenditure or income should be accounted for in the HRA, the test that should be applied is "Who benefits?" That is to say: who is the major contributor of the item of income, or the major beneficiary of the expenditure under consideration? Hence, should the HRA bear the full cost or only part, or should it benefit from the entirety of the income, or is some of it applicable to the General Fund?

In some cases, such as rental income or expenditure on housing repairs, it is clear that the HRA is the correct accounting vehicle. Conversely, legislation places transactions concerning rent rebates and housing benefits in the general fund. Nevertheless, there is a substantial 'grey area' of items of income and expenditure where differing and perhaps unique local circumstances will suggest different solutions. These are the decisions where local flexibility is best employed using the "who benefits?" approach.

The main consideration when deciding whether the costs and income associated with a particular property should be accounted for in the HRA is the powers under which the authority is currently providing that property. Section 74 of the 1989 Act sets out the property that must be accounted for in the HRA, by reference to the powers under which that property is held.

A property has to be accounted for within the HRA if it is currently provided under Part II of the 1985 Act or any of the other powers specified in section 74 of the 1989 Act (referred to here as "Part II housing"). The account also extends to any outstanding debts or receipts which arose when a property was so provided and which are still outstanding following its disposal.

If a property is not provided under the powers listed in section 74(1), or covered by a direction under section 74(1)(f), the authority must not account for it in the HRA - subject to certain exceptions set out in section 74(3). The HRA (Exclusion of Leases) Direction 1997, made under section 74(3)(d) of the 1989 Act, excludes from the HRA leases of up to 10 years for dwellings taken out by authorities for the purpose of housing homeless households.

If an authority wishes to include in the HRA property which is ancillary to Part II housing but not up to now provided under Part II, it will be necessary to obtain consent from the Secretary of State under section 12 of the 1985 Act (see also section 15 of the 1985 Act for London authorities). Such applications will be considered on their individual merits.

Equally, properties which may originally have been provided under one of the powers in section 74 of the 1989 Act (or their predecessor powers) may no longer fulfil their original purpose. In these circumstances, the authority should consider their removal from the HRA by appropriating the property to a different purpose. Examples of properties which might fall into this category are estate shops and other commercial premises, such as banks, post offices, workshops, public houses, industrial estates and surgeries, where there is no longer any connection with the local authority's housing.

The decision is for the authority to take, though it should be able to explain the basis of its decision to its external auditor and tenants, if called upon to do so.

Authorities should have regard to the powers available to them to hold property when they are considering whether to appropriate it out of the HRA. Section 19(2) of the 1985 Act requires authorities to obtain the Secretary of State's consent before a house, or part of a house can be appropriated for any other purpose.

If a property is transferred between the HRA and any other revenue account within the General Fund, this will involve adjustments to the HRA and other revenue accounts in accordance with any direction under paragraph 5(1) of part 3 of Schedule 4 to the 1989 Act and HRA capital financing requirements, and in accordance with the relevant determinations under Chapter 3 of Part 7 of the Localism Act 2011.

### [Amenities](#)

These include play and other recreational areas, grassed areas and gardens and community centres. In each case it is for the authority to form its own judgement on whether provision is proper under Part II of the 1985 Act and the extent to which the costs should be charged to the HRA. There can only be a charge to the HRA where the amenities are provided and maintained in connection with Part II housing accommodation.

Where an amenity is shared by the community as a whole, the authority must have regard to paragraph 3 of Part III of Schedule 4 to the 1989 Act. This requires a contribution to be made from the General Fund to the HRA reflecting the general community's share of the amenity.

## Management and maintenance services

The landlord is often best placed to provide wider services for neighbourhoods and communities that go beyond their traditional remit. When taking decisions locally, authorities need to demonstrate transparency to both tenants and Council Taxpayers that there is a fair apportionment of costs between the HRA and the General Fund.

To assist in determining what should and what should not be charged to the HRA, management and maintenance services can be expressed as core, core plus or non-core services.

Core services may be regarded as the 'bricks and mortar' functions of housing management, maintenance, major repairs and any associated debts and so forth. They are generally provided for the principal benefit of the landlord's tenants and leaseholders, not the wider community. Core plus services are those provided as additional services ancillary to the primary purpose of housing provision, which may have wider benefits to the overall community. A service that cannot be defined as core or core-plus should be accounted for in the council's General Fund.

### Core services

- Repair and maintenance
  - Responsive
  - Planned and cyclical
  - Rechargeable repairs
- General tenancy management
  - Rent collection and arrears recovery
  - Service charge collection and recovery
  - Void and re-let management
  - Lettings and allocations of HRA properties only, any work carried out in respect of non HRA properties should be charged to the General Fund
  - Management of repairs
  - Antisocial behaviour: low level
  - General advice on tenancy matters
- General estate management
  - Communal cleaning
  - Communal heating and lighting
  - Grounds maintenance
  - Community centres
  - Play areas

- Estate officers and caretakers
- Neighbourhood wardens
- Concierge
- CCTV
- Policy and management
  - HRA share of strategic management costs
  - Setting of rent levels, service charges, and supporting people charges
  - Administration of the Right to Buy

### **Core plus services**

- Contribution to corporate antisocial behaviour services. Where the service is entirely charged to the General Fund it may be appropriate for the HRA to contribute to these costs
- Tenancy support
- Maintenance of tenant gardens - unless a separate charge is made for the service
- Supporting people services - HRA housing related support services only, for example:
  - Sheltered accommodation wardens
  - Alarm services

### **Non-core services**

It is the view of MHCLG that it is inappropriate to assume that these services will be wholly charged to the HRA. Their costs should be met from the General Fund.

- Administration of a common housing register – costs should be split appropriately between the HRA and General Fund
- Street lighting
- Dog wardens
- Personal care services
- Homeless administration
- Housing advisory service

The landlord should decide, within the requirements of existing legislation, whether it is appropriate to account for a proportion of these in the HRA or in the General Fund, using the 'Who benefits' principle. If the benefits of the service accrue primarily to the wider community, it is probable that the cost is a better fit in the General Fund, though it would be permissible to recoup a portion of any such cost from the HRA where it can be demonstrated that there is a benefit to HRA tenants or properties.

This does not imply any general discretion to transfer resources across the ring-fence; rather it is for the authority to apportion any costs or income for a service appropriately between accounts to reflect the benefit enjoyed by HRA tenants and leaseholders on one hand and the wider council taxpayer on the other.

Where a local authority is taking decisions concerning the correct place to account for new services or is reviewing existing practice in the light of evolving circumstances, the government would expect that tenants should be consulted, or involved in the decision-making process.

### Homelessness administration

Authorities should consult the decision of the Court of Appeal in *R. v London Borough of Ealing, ex parte Lewis*, (1992) 24 HLR 484, when deciding how to account for homelessness administration costs. The case decided that not all the costs associated with homelessness administration by Ealing Borough Council should be charged to the HRA; only costs that fall within the description of 'management of houses and other property' can be included in the HRA.

### Housing advisory services

The Court of Appeal's decision referenced above also covered Ealing Borough Council's costs on housing advisory services. Authorities should have regard to this aspect of the decision when considering the apportionment of costs relating to the provision of housing advice.

## Part B: Workstream B Report

## 7. Introduction

### Background

The focus of CIPFA's HRA Review (Phase 1) on behalf of Nottingham City Council (NCC) was the nature of the payments made by Nottingham City Homes (NCH) to NCC since 2014-15. NCC is dealing with the conclusions drawn in relation to this series of payments and the consequences for NCC and NCH.

In addition, however, the Phase 1 report identified the potential for further breaches of the HRA ring-fence:

#### **Use of HRA funds to fund non-HRA activities**

Concern has been raised during the course of our work about the possibility of HRA funds (or resources paid for by the HRA) being utilised by NCH on non-HRA activities.

Given that NCH needed to undertake a one-off exercise to support our current work in order to identify surpluses derived from HRA and non-HRA activities, it could be implied that there may be insufficient segregation and analysis of source of funds, application of funds and any resulting surplus or loss resulting from HRA and non-HRA activities undertaken by NCH.

The position is made more complex by inter-group transaction relating to services provided by NCH to its subsidiaries.

There is thus the likelihood that HRA funds provided to NCH are applied to non-HRA activities. This could potentially lead to breaches to the integrity of the HRA ring-fence.

There has been insufficient scrutiny of how HRA funds provided to NCH to ensure that HRA monies are spent on HRA related activities. This is exacerbated by the weakening of the HRA client function in NCC as a result of restructuring in 2016 together with the growth in NCH of non-HRA activities since the establishment of NCHEL and NCHRP in 2015.

It is also clear, from discussions held with NCH, that NCH does not consider that there is any obligation for it to account separately for HRA funds provided to it in relation to the services it provides to HRA tenants on behalf of NCC.

The focus of our work in Phase 2 (Workstream B) was, therefore, to identify the extent to which HRA monies were spent on HRA activities by NCH. Such analysis has been

dependent on the sufficiency and adequacy of NCH's accounting records in allowing us to analyse the source and application of HRA (and non-HRA) funds.

This report sets out:

- Part 3: HRA funding and expenditure by NCH between 2014-15 and 2020-21
- Part 4: The steps required to regularise the ring-fencing of HRA funding in future

## Acknowledgement

We are grateful for the constructive manner in which staff in NCH and NCC have provided information and responded to our queries.

## 8. HRA funding and expenditure by NCH between 2014-15 and 2020-21

As NCH does not consider that it has any obligation to ring-fence HRA funds, there is no statement available to show how such monies received have been applied each year. In the circumstances, therefore, we have focused on the income and expenditure in the consolidated financial statements for NCH each year in order to establish how HRA funds have been utilised. This section outlines:

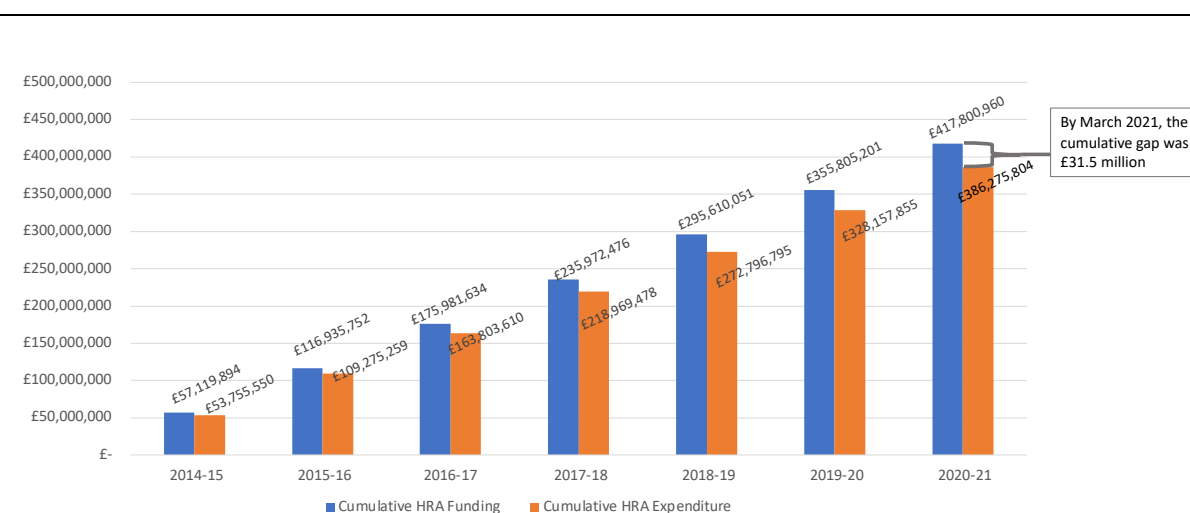
- The extent of the gap in HRA funding and expenditure between 2014-15 and 2020-21
- Our approach to quantifying the gap

### The extent of the gap in HRA funding and expenditure between 2014-15 and 2020-21

The funding from the ring-fenced HRA account received by Nottingham City Homes Ltd and its subsidiaries between 2014-15 and 2020-21 exceeded its spending on HRA activities. As **Figure 1** below demonstrates, cumulative funding reached £417,800,960 by the end of 2020-21, whereas cumulative expenditure was £386,275,804. As a consequence, funding has exceeded expenditure by £31,525,117.

The gap grew the most between 2014-15 and 2018-19. HRA funding exceeded expenditure in 2014-15 by £3,364,344 and for the subsequent four years, funding increased by 4 per cent whereas expenditure remained the same. The difference closed somewhat between 2019-20 and 2020-21 when funding increased by 4 per cent, whereas expenditure rose by 8 per cent. This was mainly due to the construction of new council houses at Tunstall Drive and significant capital works in response to the Grenfell Tower tragedy to improve sprinkler systems and intercom speakers etc.

**Figure 1: Cumulative HRA funding and expenditure between 2014-15 and 2020-21**



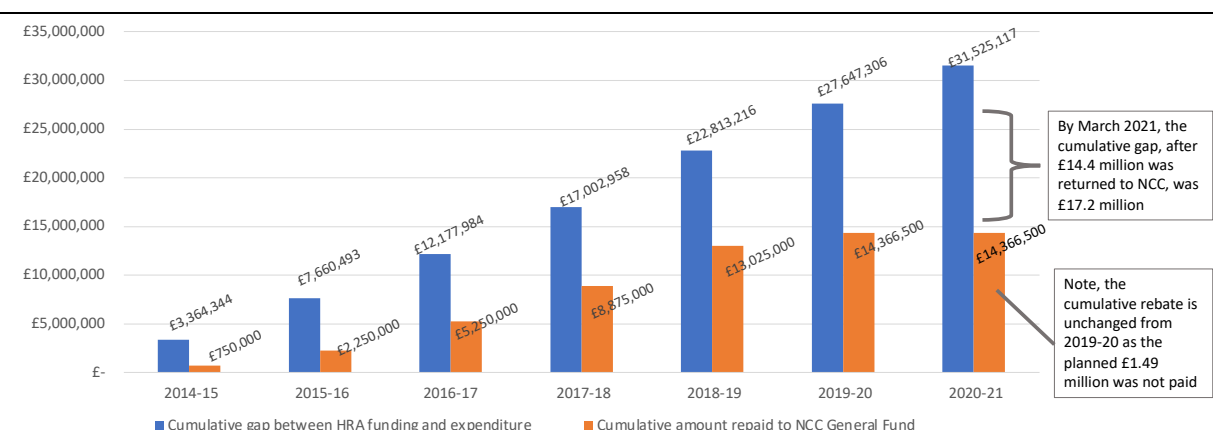
Source: CIPFA analysis of NCH data

The scale of the gap shown in Figure 1 does not take into account the annual payments made by NCH to NCC. Our previous report confirmed that such payments, after in-year adjustments, amounted to £14,366,500 between 2014-15 and 2019-20. The payments made by NCH to NCC were paid into the General Fund to help ameliorate the financial pressures facing the City Council. A further £1,492,000 was expected to be paid in 2020-21, but this transaction was halted.

We understand that NCC is already taking action to return the cumulative annual payments of £14,366,500 to the HRA. It is important, therefore, that these amounts are excluded from the calculation. As a consequence, **Figure 2** shows the scale of the remaining difference once these annual payments are removed.

On the assumption that the £14,366,500 is returned to the HRA, there remains a difference of £17,158,617 between HRA funding and HRA expenditure from 2014-15 to 2020-21.

**Figure 2: The cumulative excess of HRA funding over HRA expenditure between 2014-15 and 2020-21 compared to the annual payments made to NCC**



Source: CIPFA analysis of NCH data

The capacity for NCH to remedy this gap without support from the Council is constrained. The consolidated accounts for 2020-21 show that NCH did have a cash balance of £15,673,588 on 31 March 2021. This was essentially due, however, to the net receipt of £22,759,590 in loans from NCC in 2020-21 for non-HRA projects, such as the development of market rented properties by NHCEL (project 26047) and the developments at Arkwright Walk (projects 26049 & 26050) and the Clifton Triangle (project 26051). NCH explained that these loans were to replenish cash balances previously utilised to forward fund non-HRA investments. As figure 2 shows that there was an excess of HRA funding over HRA expenditure each year between 2014-15 and 2020-21, it is highly likely that the non-HRA investments were funded using HRA monies and have subsequently been replenished through a non-HRA loan. As we noted in our previous report, however, funding the HRA from the General Fund and vice versa represents a breach of the HRA ring-fence and so requires a formal direction from the Department for Levelling Up, Homes and Communities.

## Our approach to quantifying the gap

Our approach involved:

- Stage 1: Establishing the account codes underpinning the 2020-21 consolidated financial statements
- Stage 2: Assigning each account code as, HRA, non-HRA or mixed
- Stage 3: Determining the reasonableness of the HRA and non-HRA allocations for each cost code

- Stage 4: Applying the categorisation developed for 2020-21 to the financial years 2014-15 to 2019-20
- Stage 5: Establishing the extent of any impact on the ring-fenced HRA fund

The following sections explain the work done and the key issues that arose during our work.

## Stage 1: Establishing the account codes underpinning the 2020-21 consolidated financial statements

Our initial work involved confirming that the group account trial balance for 2020-21 aligned with the financial statements, the basis of the recharges between NCH, NCHRP and NCHEL, and thus the financial relationship between NCC, NCH and its subsidiaries. Key issues arising are set out below.

- A. **The consolidated financial statements for NCH are dependent on a series of spreadsheet adjustments made at year end that are not clearly explained.** The spreadsheet with the trial balance includes a number of additional inter-company adjustments, tax adjustments, accruals and reserves adjustments. There are also figures in the preparation of the accounts, such as the composition of creditors, that are derived elsewhere. Whilst the NCH Director of Corporate Resources has been helpful in clarifying such queries, the absence of clearly explained working papers and robust supporting evidence together with the over-reliance on one individual to explain the transactions, risks, and potential delays in the preparation of financial statements in future.
- B. **There is no ring-fencing of the management fee and repairs maintenance fee from the HRA.** Both funds are booked to a single account code (6005) and there are no other transactions against this account code<sup>1</sup>. In practice, this means that they are used as the 'de facto balancing item' on other cost codes. For example, the difference between the spend of nearly £684,000 on commercial repairs (code 5969) and associated non-HRA funding of nearly £472,000 in 2020-21 is likely to be effectively met from code 6005. There are 21 account codes that follow this pattern, with a net difference of £303,995 likely to be met from HRA funds. Similarly, there are also financial accounting codes used by NCH in 2020-21 that do not ring-fence HRA funding from non-HRA funding. The code 2800 for the Lettings Team, for example, includes nearly £453,000 NCC HRA funding, as well as £109,000 non-HRA funding from elsewhere. There are 10 account codes that include both HRA and non-HRA

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<sup>1</sup> In comparison, capital fees and works are assigned to specific cost centres.

funding sources, with collective HRA funding of £2,135,075 and non-HRA funding of £639,464.

- C. There is insufficient differentiation between the accounting records for NCH and its two subsidiaries.** NCHEL has been assigned its own accounting code on the ledger (code 6009) and NCHRP the accounting codes 7000 to 7050. These codes are used to compile each company's accounts, but they do not enable differentiation between types of expenditure. For example, the costs incurred for relying on NCH staff and other resources are collated and booked to the inter-company subjective 'sub-contractors'. As a consequence, the financial statements for NCHRP and NCHEL do not provide any breakdown of operating costs and we have found it difficult to validate the figures.
- D. We have not been able to confirm that NCH records of the funding received from NCC in 2020-21 reconcile with NCC records.** The difficulties in reconciling the figures are possibly due to a lack of staff availability/familiarity with records. Nevertheless, there should be clear and available working papers that confirm the sums.

## Stage 2: Assigning each account code as HRA or non-HRA

Our work involved consultation with NCH staff in order to establish the nature of each function and applying the 'who benefits' test to the functions associated with each account code. All activities undertaken by the two subsidiary companies, NCHEL and NCHRP, are non-HRA, but there are also other non-HRA activities undertaken by NCH.

We assigned 54 cost centres in 2020-21 as HRA – see Appendix 1. The list includes cost centres, such as repairs and maintenance where the activity covers both HRA and non-HRA work, but the non-HRA is removed through re-charges. We assigned 23 cost centres as non-HRA – see Appendix 1. These cost centres largely comprise commercial activities and the costs associated with properties owned by NCHRP and NCHEL.

The key issues arising are:

- A. We have challenged NCH's assessment that the cost of some programmes were associated with HRA funding.** The re-assignment of spending on 'Nottingham on Call' and the programme to improve energy efficiency as non-HRA is based on the principle that the schemes are not exclusive to Council tenants. These initiatives had combined expenditure of £2.6 million, with non-HRA funding of £1.7 million in 2020-21. We re-assigned all these costs as non-HRA accordingly.

- B. **As it has not yet been feasible to separate the components of the 'Central Charges' cost code (6004) between HRA and non-HRA, costs were apportioned instead.** This cost centre comprises the costs incurred under the SLA with NCC for central services, such as IT and EMSS, as well as insurance costs and re-charges to NCHRP and NCHEL. We apportioned the expenditure between HRA and non-HRA based on property numbers managed by NCH (2,120 non-HRA out of a total of 27,513).

### Stage 3: Determining the reasonableness of the HRA and non-HRA allocations for each cost code

NCH rely on inter-company recharges and the Northgate (NEC) housing management system to identify costs associated with the management of non-HRA properties. We examined how such costs are calculated and the journal entries required to extract non-HRA costs from otherwise HRA cost codes. The key issues arising were:

- A. **NCC and NCH are determining the costs of maintenance and repair works and capital works based on a schedule of rates that cannot be validated.** The rates are bespoke to NCH and there is no record of how they were compiled. Without being able to substantiate the basis of each rate, it is not possible to confirm whether the costs incurred are reasonable. In the absence of such information, we have not amended the HRA and non-HRA allocations to reflect this issue.
- B. **The Northgate system is highly likely to understate the costs associated with maintenance and capital works.** An exercise undertaken by the Director of Property Services found significant shortfalls when comparing actual costs incurred against the schedule of rates for a sample of works done. This is likely to arise as we understand that the schedule of rates has not been regularly updated since they were established around 2013. The extent of the shortfall is estimated to be at least 20%. The impact of this discrepancy is that charges to subsidiaries and non-HRA activities could be significantly understated, in effect providing an illegitimate HRA subsidy. We have, therefore, increased the non-HRA costs associated with such activities by 20%, thereby reducing the HRA spend.
- C. **The cost of works done by the in-house Construction Repairs and Maintenance team does not include the cost of central overheads within NCH.** Our understanding is that the rates cover the materials and direct labour costs for the teams, as well as an element of overhead for the management team and

administrative staff within the directorate. The rates do not, however, include the costs associated with the management team in NCH or central administrative functions, such as finance, HR, IT etc. Given the likely under-recovery of costs for work undertaken by the in-house Construction Repairs and Maintenance team, we have assigned an additional 20% of the recharges as non-HRA.

**D. Non-HRA costs are charged to NCH's subsidiaries, but the amounts are based on assumed costs per property rather than actual costs.** For example, the service level charge per 50 dispersed properties of £286,000 includes:

- Employee costs of £154,329 – based on an assumption of 3.8 Grade 5 staff at £33,115 and 0.6 Grade 8 staff at £45,650.
- Voids cleaning/other of £42,089 – based on the assumption of each of the 50 properties being cleaned twice a year at £400 each, plus an extra £2,089 for 'other' works.
- Repair costs of £39,000 – based on the assumed need to recommission gas and electrics for each of the 50 properties twice a year at £390 each time.
- Alarm/contact service of £24,811 based on the assumption of having to pay individual(s) £9.54 per week, per property.

There is also an overhead charge of £24,579, but we have not been able to establish the basis of this figure. In the absence of reliable data, we have not revised the HRA and non-HRA allocations to reflect this issue.

#### Stage 4: Applying the categorisation developed for 2020-21 to the financial years 2014-15 to 2019-20

Having determined the basis of the allocations for 2020-21, we applied the same principles to earlier years. The account codes are essentially the same each year – there were 21 codes in 2020-21 that did not exist in previous years, and 13 codes that existed in earlier years but not in 2020-21. The latter were either incorporated into other codes (such as 'Company Secretary' becoming part of 'Governance') or reflected specific HRA projects, such as the construction of council houses at Amber Hill and the installation of smoke alarms.

Key points to note are:

- **The extent of the understatement of costs by the Northgate system is likely to be lower in earlier years.** We had assumed a 20% understatement in 2020-21.

Accordingly, we assumed an understatement of 18% in 2019-20, 16% in 2018-19, decreasing by 2% each further year to 8% in 2014-15.

- **Where costs were apportioned on the basis of the number of HRA and non-HRA properties managed by NCH, we have revised the proportions to reflect the breakdown in earlier years.**

## Stage 5: Establishing the extent of any impact on the ring-fenced HRA fund

In order to determine the extent of the gap between HRA funding and expenditure each year, we assigned each cost code against the headings used in the financial accounts and reconciled the totals to each set of audited financial statements.

Accordingly, the table below shows HRA funding and expenditure each year.

HRA Income & Expenditure	2014-15 (£)	2015-16 (£)	2016-17 (£)	2017-18 (£)	2018-19 (£)	2019-20 (£)	2020-21 (£)
<b>Turnover</b>							
<u>NCC funding:</u>							
□ Management fee	22,014,000	23,005,000	22,516,000	22,841,996	22,996,000	22,374,000	22,649,000
□ Repairs and maintenance	26,804,150	27,260,000	27,260,000	27,329,000	27,167,000	26,899,000	26,884,000
□ Capital fee	2,257,573	2,631,587	2,857,612	2,301,939	1,829,757	1,637,978	1,155,738
□ Capital works	5,779,211	6,694,921	6,174,041	7,212,739	7,322,902	8,328,748	10,449,612
□ NCC other	264,960	224,350	238,230	305,164	321,913	955,424	857,409
<b>Total income</b>	<b>57,119,894</b>	<b>59,815,858</b>	<b>59,045,882</b>	<b>59,990,842</b>	<b>59,637,575</b>	<b>60,195,150</b>	<b>61,995,759</b>
<b>Expenditure</b>	<b>53,755,550</b>	<b>55,519,709</b>	<b>54,528,351</b>	<b>55,165,868</b>	<b>53,776,543</b>	<b>55,328,423</b>	<b>58,103,803</b>
Interest payable/receivable	0	0	0	0	50,744	32,637	14,146
<b>Operating Profit (Loss)</b>	<b>3,364,344</b>	<b>4,296,149</b>	<b>4,517,491</b>	<b>4,824,974</b>	<b>5,810,258</b>	<b>4,834,090</b>	<b>3,877,811</b>

Similarly, the table below shows the commensurate non-HRA income and expenditure each year:

Non HRA Income & Expenditure	2014-15 (£)	2015-16 (£)	2016-17 (£)	2017-18 (£)	2018-19 (£)	2019-20 (£)	2020-21 (£)
<b>Turnover</b>							
<u>NCC funding:</u>							
<input type="checkbox"/> Repairs and maintenance	61,014	263,638	731,382	1,376,093	1,706,909	1,540,453	444,999
<input type="checkbox"/> Nottingham on call	613,033	561,012	715,696	920,770	944,478	831,829	818,120
<input type="checkbox"/> NCC other	626,111	1,618,828	1,098,509	613,596	330,417	524,063	528,168
<u>Other income sources:</u>							
<input type="checkbox"/> Rental income	17,085	215,774	467,158	1,045,231	2,608,073	3,974,626	5,938,808
<input type="checkbox"/> Govt funding	0	0	253,322	124,016	144,054	562,415	710,305
<input type="checkbox"/> Other	941,302	925,296	566,476	815,992	1,051,273	1,180,450	1,472,195
<b>Total income</b>	<b>2,258,545</b>	<b>3,584,548</b>	<b>3,832,543</b>	<b>4,895,699</b>	<b>6,785,204</b>	<b>8,613,835</b>	<b>9,912,596</b>
<b>Expenditure</b>	<b>4,074,624</b>	<b>4,371,874</b>	<b>4,285,553</b>	<b>5,372,187</b>	<b>6,294,136</b>	<b>8,017,265</b>	<b>8,677,890</b>
Interest payable/receivable	(15,476)	51,373	269,977	498,971	725,647	1,045,402	1,299,190
<b>Operating Profit (Loss)</b>	<b>(1,800,603)</b>	<b>(838,699)</b>	<b>(722,987)</b>	<b>(975,459)</b>	<b>(234,579)</b>	<b>(448,832)</b>	<b>(64,484)</b>

## 9. The steps required to regularise the ring-fencing of HRA funding in future

In our opinion, the duty of a Local Housing Authority (LHA) is to ensure that HRA monies are only spent to the benefit of HRA tenants (the “Who benefits?” test) does not cease when an LHA enters into arrangements for a service provider to provide services to tenants on its behalf. There remains a statutory responsibility on the LHA to ensure that HRA funds provided to the service provider (and consequently outside the day-to-day control of the LHA) are spent to the benefit of tenants. This applies to HRA monies provided by NCC to NCH.

It is also clear, from discussions held with NCH, that they consider that there is no obligation on them to account separately for HRA funds provided or to demonstrate that such monies are only utilised on the services it provides to HRA tenants on behalf of NCC.

Consequently, current reporting and accounting arrangements with NCH do not provide assurance to NCC (as the LHA) that HRA monies have been properly spent to the benefit of HRA tenants only; i.e. that the “Who benefits test?” extends to the provision of services provided to tenants by NCH on behalf of NCC. This will need to change in future.

More robust arrangements between NCC and NCH in relation to HRA monies (though they equally apply to GF monies provided to NCH) should be applied to protect the interests of HRA tenants. Our interim report identified three key areas:

- **Budgeting.** NCC needs to agree a budget for each element of HRA funding (Management Fee, Repairs Fee etc.) with NCH. In the past this appears to have been done on an incremental basis and at an insufficiently granular level of detail, with the potential of conflating HRA and non-HRA spending pressures on NCH. Ideally, this would be based on a zero-based budgeting exercise, though we recognise it is too late for this to happen in agreeing the 2022-23 budget. Such an exercise, however will allow NCC in dialogue with NCH, to properly cost the services provided to the HRA at an appropriately granular level of detail (e.g. which posts or proportion of a post are funded by the HRA in NCH). NCC should also consider what might be a reasonable level of surplus for NCH to earn from the services it provides to the HRA if this is considered appropriate.

- **Service Level Agreements (SLAs).** Budgets for the HRA funding provided to NCH should be set and agreed with NCH on the basis of granular SLAs (encompassing the Management Fee, Repairs Fee etc.) that sets out the purposes for which the funding is provided and the spending that the funded is intended to support (e.g. which posts or proportion of a post are funded by the HRA in NCH).
- **Reporting and Accounting.** NCC should require NCH to account for and report on HRA activities separately from non-HRA activities (encompassing both financial and non-financial reporting). This will enable NCC as the LHA to:
  - Have clarity on how HRA funds have been applied by NCH and determine whether HRA funds provided to NCH have been fully spent on HRA activities (excluding any reasonable surplus that has been agreed and built into the arrangements between NCC and NCH);
  - Determine, where HRA funding provided to NCH has not been fully spent on HRA activities, to what extent a legitimate rebate to the HRA is appropriate or, potentially, the sum be carried over to reduce the burden on the HRA in future years;
  - Have clarity on budgetary pressures experienced by NCH in relation to HRA activities in isolation (budgetary pressures in relation to services funded by the GF should be dealt with separately) and determine how these should be dealt with in subsequent budgets (e.g. though increased funding and/or savings/efficiencies within NCH);
  - Report on HRA spend on an “actuals” basis in the annual HRA financial statement (we understand HRA spend is currently reported on the basis of funds provided to NCH so effectively what is budgeted rather than what has been spent).

In relation to the intra-group company transactions within the NCH, NCC, as sole shareholder, should require that:

- Ensure that costs are properly charged between companies throughout the year based on actual costs. This should include all relevant overhead costs.
- Maintain balance sheet records for each company to include property assets for those properties under the control of the relevant subsidiary
- Provide monthly management accounts for NCC on each of its subsidiaries and present draft accounts for each entity to NCC both pre and post audit.

Following on from our interim report, we sought to separate the balance sheet between HRA and non-HRA activities. This proved problematic and highlighted a number of other issues that will also need to be addressed:

- **Fixed assets.** It should be relatively straight forward to differentiate HRA from non-HRA assets. Any land and buildings within the NCH consolidated accounts would constitute non-HRA assets. In practice, however, we were unable to reconcile the list of properties managed on behalf of NCC – the list held on the Northgate system (31 March 2021) refers to 25,328 properties, whereas the records supporting the financial statements for NCH refer to 25,393. There is a discrepancy of 65 properties that we have been unable to reconcile. It is not clear if the additional 65 properties are Council owned or NCH owned. There should be regular reconciliations to support the fixed asset registers held by the Council and NCH.
- **Working capital.** We have not been able to establish a satisfactory breakdown of debtors and creditors between HRA and non-HRA activities, and thus the cash flow impact on the closing cash balance. The working papers supporting the associated figures in the financial statements are difficult to follow, and the volumes of individual transactions that compile the figures mean it would be a considerable task to unpick the numbers with any accuracy. In the circumstances, any differentiation required between HRA and non-HRA for past years may be more cost effective if it were based on a retrospective apportionment based on the number of HRA and non-HRA properties instead.
- **Equity.** Whilst the separation of income and expenditure between HRA and non-HRA activities enables the impact on the profit and loss reserve to be determined, £45.8 million of the £49.9 million change in equity (92 per cent) from March 2020 to March 2021 was due to increases in the actuarial value of defined benefit pension obligations and in the fair value of pension fund assets held. Segregating the pension values of HRA funded staff from non-HRA funded staff for past years is difficult and, as with working capital, it may be more cost effective if it were based on a retrospective apportionment based on the number of HRA and non-HRA properties instead.

## Annex 1: The allocation of cost centres in 2020-21 as HRA and non-HRA

Cost code	HRA	Non-HRA
Adaptations	x	
Apprentices	x	
Aspley Area Office	x	
Asst Director Housing Services	x	
Asst Director Tenancy & Estate	x	
Asset Planning & Strategy	x	
Assistant Director Asset Manag	x	
Beechdale Court	x	
Bestwood Area Office	x	
Building Expenses	x	
Building Safety Team	x	
Bulwell Area Office	x	
Business Intelligence	x	
Business Transformation	x	
Capital Grants Received in Adv	x	
Capital Programme Delivery	x	
Central Charges	x	
Central Charges RP		x
Chief Executive	x	
Clifton Area Office	x	
Commercial Team		x
Commercial Works - Arboretum 1		x
Commercial Works - Forest Road		x
Commercial Works - Harvey Road		x
Commercial Works - NCC Repairs		x
Communications & Marketing	x	

Cost code	HRA	Non-HRA
Communications Team	x	
Customer Experience	x	
Day to Day	x	
Decent Neighbourhoods	x	
Developments	x	
Director of Corporate Services	x	
Director of Housing	x	
Dispersed Tenancies		x
Dispersed Tenancies Acquisition		x
District Heating	x	
Door & Window Renewals	x	
Driveway Works	x	
Electrical Contract Costs	x	
Employment Provision		x
Energy - Communal		x
Energy Delivery		x
Estate Caretaker Service	x	
Estate Works	x	
Finance	x	
Fire Damaged Properties	x	
Fire Risk Response	x	
Fit for the Future		x
Gas, Smoke Alarm & H/Watch Ser	x	
Governance	x	
Grander Designs	x	
Head of Governance, Risk & Com	x	
Heating & Boiler Installations	x	
Heating Installations Phase 2	x	
Heating Repairs	x	

Cost code	HRA	Non-HRA
High Rise Living	x	
Highwood House		x
Hyson Green Area Office	x	
Independent Living Complexes	x	
Independent Living Mngt	x	
Internal Maintenance Works	x	
IT Expenses	x	
Kitchens & Bathrooms	x	
Landlord Services Stonebridge		x
Landlord Services Wainwright		x
Leaseholder & Rechargeable Rep	x	
Lettings Team	x	
Lift Maintenance	x	
Loxley Accommodation	x	
Major Electrical	x	
Major Works	x	
Management Fee Income	x	
Market Rented		x
Mechanical Contract Costs	x	
Move-On		x
NCH Owned Properties		x
NCH RP Dispersed Tenancies		x
NCH RP Dispersed Tenancies 2		x
NCH RP Highwood		x
NCH RP Private Sector Leases		x
NCH RP Social Housing		x
New Build - Wells Road	x	
Nottingham On Call		x
Organisational Development	x	

Cost code	HRA	Non-HRA
Out of Hours	x	
Painting	x	
Private Sector Leasing		x
Radius Cash Receipting Susp		
Rents Team	x	
Repairs & Maintenance AD	x	
Revenue Voids	x	
Risk Management	x	
Safer Neighbourhood Housing	x	
Sanctuary		x
Section 106 Agreements		x
Service Level Agreements	x	
Sprinkler Installations	x	
St Anns Area Office	x	
Stores	x	
Technical Services	x	
Tenant & Leaseholder Involvement	x	
Tenants Community Facilities	x	
Transport	x	
Tunstall Drive	x	
Vehicle Grant	x	
Victoria Centre Area Office	x	
Voids Cleansing	x	
Zedra		x