



**Broomfield**  
Alexander  
professional advisors

## **Social Housing Technical Update**

SUMMER 2010

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VAT SPECIALISTS 

## In This Issue

The Broomfield & Alexander Housing Team are delighted to present the Summer 2010 edition of our technical update. Our Spring 2010 edition brought you up-to-date with a number of technical matters (including component cost accounting and other forthcoming SORP changes) in respect of which we still await the fine detail. In the meantime, our Summer 2010 edition will focus more on practical solutions to perennial problems and cover the following topics:

### 1. Combating fraud

We take a look at how to make the most appropriate response in the fight against fraud – how to map out your risk and identify susceptibility and how to make sure your control framework is effective.

### 2. VAT – how to get value out of value added tax

Liz Maher, Director of Centurion VAT Specialists and widely recognised VAT expert, helps us to prepare for the increase in the standard rate and provides us with a reminder of the relief that might be available to organisations having charitable status.

### 3. Planning points

Other important changes are afoot. We help to make sure you are up-to-date with changes to:

- income taxes
- audit requirements for service charge statements;
- component cost accounting; and
- the question of registration with the Charity Commission.

These technical updates are intended to present a reference point for busy professionals which help to identify issues and suggest action points for planning.

If you require further information, please [contact our Housing Team on housing@broomfield.co.uk](mailto:housing@broomfield.co.uk) or call Justin Crowley on 02920 739414 (direct) or 02920 549939 (main office)

It's an ugly fact, but a fact nonetheless that we are all susceptible to fraud. Many organisations and their Board/trustees, are uncomfortable with the issue and as a result they are not inclined to open regular analysis and discussion of fraud risk, but doing so is critically important. Open acknowledgement of the risk and a full knowledge of where your susceptibilities lie, underline the organisation's ability to properly control their fraud risk.

One of the most comprehensive sets of fraud related data is that published each year by the Association of Certified Fraud Examiners.

Although based largely on US data, there is little reason to suspect that the trends noted are not reflected in the UK. Some of the most interesting findings are as follows:

- Organisations studied lost up to 7% of annual revenues to fraud;
- The vast majority of frauds involve very small losses (and are often opportunistic) compared to other, much less common and expensive frauds involving fraudulent financial reporting by senior management;
- Crimes involving corruption of one type or another are the most prevalent type of fraud comprising 27% of cases – fraudulent billing of organisations accounted for 24% of all fraud;
- Audits are not an effective way of discovering fraud – tip-offs and specific controls result in vastly higher detection rates (more on this later);
- Lack of adequate internal control is by far the most common enabling factor; and

- By far the most common behavioural indicators related to fraud cases were people living beyond their means (39% of cases) and perpetrators experiencing financial difficulties (34% of cases).

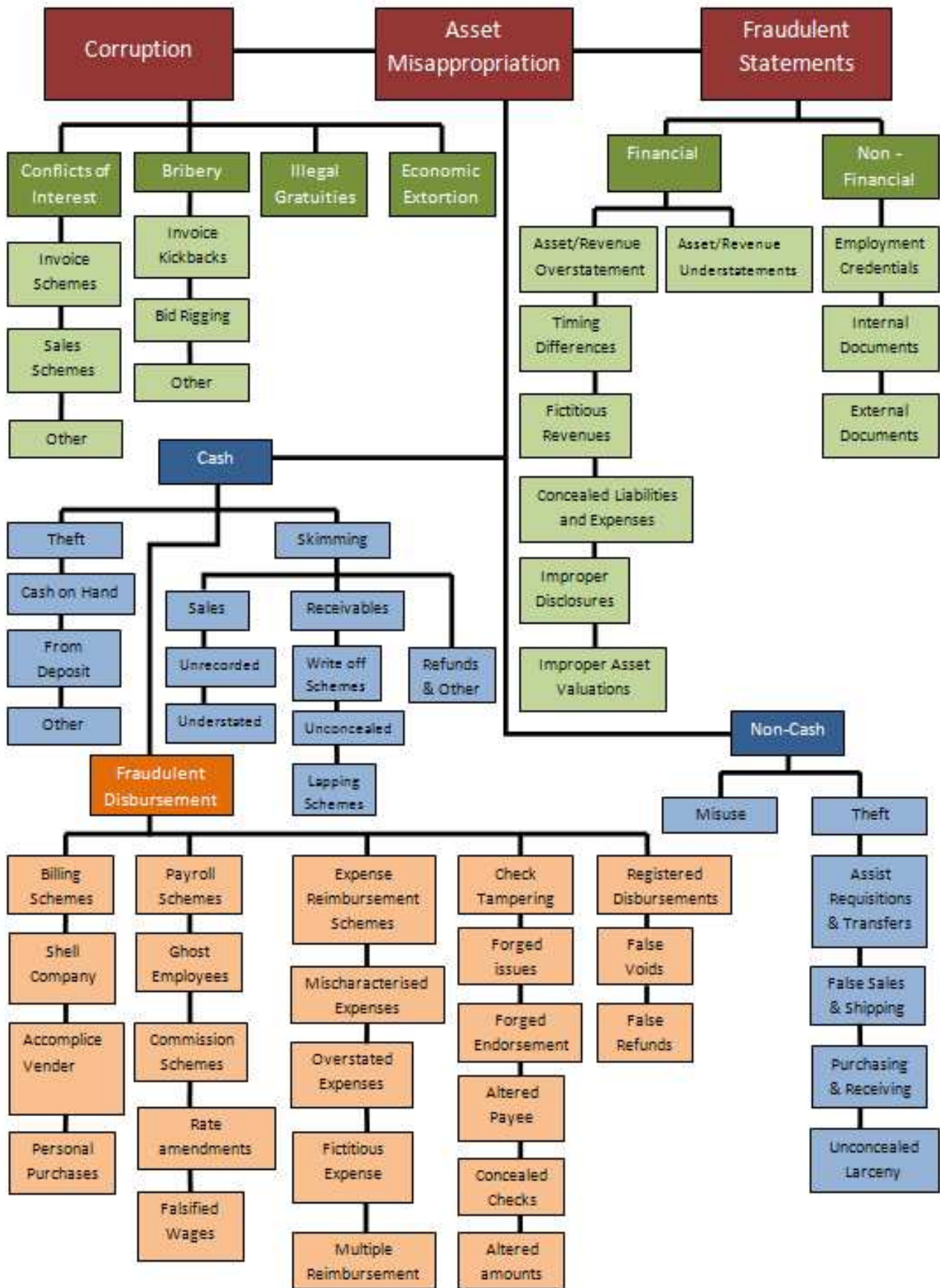
Reflecting on some of this data, this article is intended to identify the key, simple steps that an RSL could undertake to ensure that it's making an appropriate approach to fraud risk and to dispense with its responsibility to maintain a system of internal control that gives it the best chance of preventing, deterring and detecting fraud.

***Don't rely on your external auditors to detect fraud – but do challenge them*** – your auditors will plan their audit so as to have a reasonable expectation of identifying '**material**' fraud or error, but they will not necessarily go looking for non-material frauds as many might believe they do. This is commonly known as the 'expectation gap'. Don't be afraid to challenge your auditors though – they have a responsibility to assess fraud risk and your own assessment of, and responses to those risks – this could be a good place to start your own fraud risk assessment.

***Make sure you have mapped out your susceptibility to fraud*** – this is one of the most important first steps in ensuring that you have in place adequate counter-fraud systems and procedures.

You should start by formally recording all the areas in which you are susceptible to fraud. Mapping out your transactions and balances is a very good way of starting this process. The illustration shows what this fraud risk map might look like. (see diagram).

# Fraud Tree



## Combating Fraud

Think about all of the points at which your organisation conducts transactions, both internal and external. Each type of transaction, e.g. receiving cash and paying staff for example are transaction points with different types of susceptibility.

What about paying external suppliers? How do you control fraud in those instances? What controls for example exist that stop staff from setting up fictitious purchase ledger accounts to whom the organisation can subsequently make payments? Even if your controls in this respect were circumnavigated, what monitoring or other controls exist that would help you to identify fraudulent payments?

How do you ensure that all rents are being collected in full, and that all rents relate to properties that have been legitimately let via the organisation's official letting procedures? Recent high profile cases have illustrated the embarrassing consequences of not getting controls right in this area.

***Once you've mapped out your susceptibility, cross refer to controls*** – unfortunately there is no 'one-size-fits-all' approach to this. Each risk has to be looked at separately. Avoid overly complex procedures and controls and instead focus on protecting the organisation from specific risks of fraud and error.

It may be acceptable for controls to be weak in a certain area (for example where the resources available to you make independent review or segregation of duties impractical) as long as there are compensating controls in another.

Remember also that this task need not be a necessarily taxing one. The most effective controls are the ones that can feasibly be built into routine practices, procedures and reported data. The important thing here is that you make the correct start in developing a cohesive assessment of your fraud risk. Once you have made the initial investment of time, updating the assessment on an ongoing basis should be relatively simple.

***Review and test regularly*** – things change, and so too does your fraud risk – make sure that you take an occasional fresh look at your activities and your staffing structures to make sure that your controls are still appropriate – for example, organisations often use existing staff to fill temporary posts – this might open up controls to abuse where one person has an undue level of influence over transactions.

If you change processes and procedures, react to changing regulations, undertake a new area of activity, open a new site or change your operations in any way, think about whether you need to reassess specific fraud risk in that respect. The chances are you probably will.

Testing the proper application of fraud controls should fall somewhere into your internal control assurance framework. This needn't necessarily fall to internal audit. Remember that this is all about ensuring that the organisation is making the most appropriate response to its own fraud risk. Management's own periodic testing of counter-fraud controls can be a very potent weapon. Be careful however that the process is taken seriously and that no-one is above the law in this respect – all of us should be willing to accept scrutiny in an open system based upon trust.

## Combating Fraud

It's also worth remembering that some of the most effective counter-fraud controls are the simplest to implement. Entirely random, un-announced and vigorous spot-checking of transactions and balances is a very powerful deterrent, and this needn't create a culture of mistrust and fear.

The key is to communicate openly with Board, management, staff, tenants, suppliers and any other interested parties that the organisation is serious about tackling fraud, that its existence is damaging to morale, reputation and financial health and that the organisation has a duty to tackle it head on. The knowledge that there is a real possibility that at any time they might be subject to a counter fraud review of some kind, drastically changes the would-be fraudsters perception of their risk of getting caught in the act.

Neither is this about abusing our staff's civil liberties or employment rights – if responsibility for overseeing counter-fraud controls is an inherent part of job roles and duties, then there should be a legitimate expectation that performance against this will be assessed. You may wish to give consideration to reviewing job descriptions to ensure that key areas are covered.

Monitor information closely with a view to identifying unusual trends or transactions. The truth is that it is very unlikely that you'll develop a system of counter-fraud control that is infallible. Even if you do there is always the risk that the controls will be over-ridden or that staff will collude and attempt to cover their tracks. Monitoring controls can thus play a very important role in identifying unusual

trends or levels of activity, persistent adjustments to accounts or serial abusers of systems.

***Make discussion of fraud risk part of your ordinary business*** – one of the biggest dis-incentives for would be fraudsters is the knowledge that their organisation is active in trying to deter and identify fraud. Remember that fraud can be very damaging to your charity's reputation. None of us should be afraid to talk about it.

Once you have performed your detailed fraud risk assessment and identified controls, this information can be shared with the Board and your auditors and their views sought on whether there are any areas of potential susceptibility that have not been addressed.

Broomfield & Alexander have developed unique tools to help you map out your fraud risk, identify your susceptibilities and then to put in place the most appropriate counter-fraud controls to manage and deter fraud. For more information, please don't hesitate to get in touch with us at [housing@broomfield.co.uk](mailto:housing@broomfield.co.uk)

The much anticipated increase in the standard rate of VAT from 17.5% to 20% will soon be with us. The new Chancellor announced in his 22<sup>nd</sup> June 2010 emergency budget that the increase would apply from 4 January 2011. This increase is going to have a fairly significant impact on many organisation's already very tight budgets, so how should we all set about making sure that the most is made of the existing rules as they apply to RSLs and how should we best plan for the enhanced rate?

#### **Making the most of the reliefs available**

Most RSLs in Wales have charitable status for tax purposes by virtue of the charitable nature of their rules. The most obvious benefit of this status is exemption from corporation tax on any surpluses generated in respect of activities in furtherance of their charitable objects (rental income from assets vested for charitable purpose and other 'primary purpose activities').

There is a real danger that organisations having charitable status might be tempted to assume that the exemption extends also to VAT and that the organisation does not have to suffer VAT in respect of costs or to account for VAT on income. In fact, the VAT position for charities is very different to that for corporation tax as the VAT reliefs available to a charity are quite specific.

So what VAT reliefs might an RSL be able to take advantage of?

Advertising costs are a good example of a situation in which zero rating reliefs can apply in a situation in which a charity receives a supply of advertising, whether for promoting

its aims and objectives, or indeed for staff recruitment to the wider public. The zero rating covers adverts in print as well as promotion on the sides of vehicles or within the media.

The zero rating relief also includes the design costs associated with the production of the advert. It does not however include design costs related to the creation of a charity's website, although there has been a recent change to the rules to include 'pay per click' advertising provided through internet search engines.

The supply to a handicapped person for domestic or personal use, or to a charity to make available to handicapped persons by sale or otherwise, for their domestic or personal use of the following items also qualify for zero-rating relief:

- a) medical or surgical appliances designed solely for the relief of a 'severe abnormality' or severe injury;
- b) electrically or mechanically adjusted beds designed for invalids;
- c) commode chairs, commode stools, devices incorporating a bidet jet and warm air drier and frames;
- d) chair lifts or stair lifts designed for use in connection with invalid wheelchairs; hoists and lifters designed for use by individuals;
- e) motor vehicles designed or substantially and permanently adapted for the carriage of a person in a wheelchair or on a stretcher of no more than eleven persons;
- f) equipment and appliances not listed above designed solely for use by a handicapped person;

g) parts and accessories designed solely for use in or with goods described above; and the supply of a qualifying motor vehicle for a handicapped person who uses a wheelchair or is usually carried on a stretcher.

Some construction work also qualifies for zero-rating when supplied to a charity to facilitate a handicapped person's movement within any building and not just their private home. This would include items such as ramps and the widening of passages.

Other construction costs that may qualify for zero-rating relief include the construction of buildings and certain works to protected buildings, intended to be used by your charity solely for non-business purposes. This may cover the construction of new office premises for non-business purposes or expenditure related to approved alterations (but not maintenance or refurbishment) to listed buildings.

As ever, there are criteria to be met but with the increase of VAT to 20%, taking advantage of the reliefs becomes more important than ever. RSLs may benefit from reviewing their procedures for properly coding and identifying works involving qualifying disabled adaptations upon which zero rating may be possible.

## Partial Exemption Framework

Within the published framework or "guidelines" as I prefer to think of them, we get an insight into the partial exemption methods that HMRC will look favourably upon in the housing sector. The underlying thrust is to achieve a balance between complexity of administration and level of VAT recovery,

hence the standard partial exemption method (one based on turnover figures) is largely accepted in the framework as being the preferred method of choice for the sector.

It's certainly straightforward to apply and with the simplification approach (agreed from the 1<sup>st</sup> April 2009 which allows an entity to use the prior year's percentage recovery figure each return and then do a catch up at the annual adjustment) it would be likely to create the smallest time burden in terms of management and application. But - is it "fair and reasonable" in all cases?

As usual the answer will be: "it depends". As the housing sector diversifies its activities with the aim of increasing income generation, when it looks to rationalise costs through partnerships or to establish a development company outside its VAT group to assist with VAT recovery, the straightforward nature of the standard method may not create the fairest recovery of VAT.

The framework does provide examples of the types of other or "special" methods that HMRC would look kindly upon to assist in particular situations, such as:

- post stock transfer of works issues;
- new build projects; and
- methods to use where an association also manages properties of another body as well as its own tenants.

I feel the message here is clear - use HMRC's suggested routes to recovery and you'll get an agreement much more promptly agreed.

To be fair, where recovery rates are low and management time stretched, that's not a hint to ignore. The key thing is to be well informed as to the options that are available to you as an association and to look ahead to consider how planned activities may develop different lines of VAT activity in the long term.

Agreeing a partial exemption method that delivers, as far as possible, a known percentage in recovery that can be planned into the financial forecast, will be much better than never really knowing what VAT recovery value you will get until you do the end of year adjustment.

## **Preparing for the increase in the standard rate**

As we are all aware, this is not the first time that the standard rate of VAT has been used to support macro-economic policy. The reduction in the rate to 15% for the 2009 calendar year was an attempt to stimulate economic growth. This time, it's clear that the treasury intends to generate greater revenues. The 2009 decrease was accompanied by anti-forestalling measures aimed at stopping organisations from abusing the rules regarding the relative VAT point (the point at which a transaction is VATable). So too is the increase for 2011.

With the planned rate rise we have again to address the anti-forestalling measures which we saw in 2009 when the rates returned to 17.5%. The guidance issued to date is in fact exactly as was issued then.

These will add a supplementary VAT charge to transactions that span the date of the VAT rate change where:

- the supplier and the customer are connected, or,
- the supplier and any connected person who finances a prepayment by the customer, or,
- the supplier raises a VAT invoice where payment is not due within 6 months from the invoice date, or,
- the consideration amounts to more than £100,000.

Transactions outside of this, where normal commercial practice can support the invoice being raised, should be able to pass un-challenged but associations considering this route should always take advice before the transaction occurs.

For financial planning purposes, we only know the date of effective introduction of the increase and not the period of time for which the increase should be applicable. Short and medium term budgets may well be likely to take the brunt of the increase, but associations may be advised to consider the longer term impact of the rate rise, if only as part of their risk management procedures.

## **Income tax**

A great many charities will be more concerned about the impact of changes affecting payroll and personnel. In particular, the proposed introduction of a 1% increase in PAYE for both employers and employees would have the immediate effect of deleting an equivalent amount of surplus from their budget (assuming no head-count loss). The potential introduction of compulsory contributory pension schemes would be even more dramatic.

## VAT

Whichever form of tax is of greatest concern to your charity, your concern is probably justified. Changes in rates for both VAT and PAYE impact straight onto the bottom line. Risk registers and budgets would benefit from some carefully thought-out sensitivity analysis to aid financial planning.

There are a number of key changes, some of which were raised in our last technical update that associations may wish to keep in sight for planning purposes, most notably:

### Changes affecting income tax

#### *Changes announced in the emergency budget of 22<sup>nd</sup> June 2010*

The main changes that RSLs may wish to acknowledge for planning purposes relate to the increases in both the ordinary rate of employers NICs and the increase in the lower earnings threshold for those NICs.

The lower earnings threshold has been increased by £21/week from April 2011 – this will have the effect (ignoring the impact of other changes) of reducing the NI cost for employers. However, there is also an increase of 1% in the ordinary rate for employers from that date, which, all other things being equal, will increase the employers NI costs.

Whether or not there is an additional cost to the employer will depend upon the average salary costs for employers. Very roughly, there will only be a saving to the employer in respect of employees paid less than approximately £20,000, as that is the level at which the effect of the increase in the threshold is cancelled out by the increase in the rate. For any employees earning more than £20,000 then, there will be an increased cost to the employer. For those earning less than £20,000 there will be a reduction in NI costs.

The Chancellor also announced a regional NIC holiday for new businesses. During a three year qualifying period, new businesses which

start up in certain areas in greater need of economic stimulus (including Wales) will get a substantial reduction in their employer NICs. Within the qualifying period, these employers will not have to pay the first £5,000 of Class 1 employer NICs due in the first twelve months of employment. This will apply for each of the first 10 employees hired in the first year of business and operate in selected countries and regions. The scheme is intended to start no later than September 2010, but any new business set up from 22 June 2010 which meets the criteria set out in the forthcoming announcement of specific details may also benefit from the scheme.

Subject to the detailed qualifying rules defining 'new business' it is possible that certain new business models launched and supported by RSLs may be able to benefit. We await further detail.

#### *Changes affecting wardens/caretakers accommodation*

In our last update we alerted you to the end of the concession on taxing caretaker's accommodation where that caretaker is not contractually on call outside of office hours. This concession was extended to cover the 2009/10 year to give employers more time to agree relevant values of benefits, communicate with caretakers and to prepare P11Ds correctly.

Please be aware that under the present guidance the rules requiring taxation of the benefits are effective from 6 June 2011 and that disclosure of the amounts taxed will be required within P11Ds that should be submitted by 6 July 2011.

## Planning points

### Audited service charge statements

New regulations under the Housing and Regeneration Act 2008 which would have been in force by now had it not been delayed by the May 2010 general election, require RSLs issuing variable service charges to subject those statements to audit.

The next possible date for implementation is 6 October 2010 and so it is possible that the changes could come into force soon thereafter, affecting December 2011 and March 2012 year ends. This assumes of course that the regulations achieve cross-party support. RSLs are advised to watch out for further guidance in this area, and in the meantime to consider which service charge arrangements could be caught by the regulations.

### Component cost accounting

Our last update contained much discussion of component costs accounting and why it could have an impact upon RSLs. The potential change is not proving popular as for most it inevitably involves a considerable amount of work being undertaken to capture data and to consider the position that the RSL would be in if it had always adopted the policy.

We have prepared the following useful hints for those planning the capture of data in the event that they may be required to implement the change:

- get your Board on-board – think about whether your Board really understands the potential impact upon the RSL including the resource requirement;
- remember that a pragmatic approach is key – there are a huge number of variables to apply to a disparate asset base

– the assumptions you make will be key, as will overall materiality;

- think about performing some preliminary global modelling to determine which assumptions suit your RSL for which assets – then drill down and plan where your data needs to come from – think about also developing a team;
- decide exactly how you will capture data and be mindful of how you will take this new approach forward in terms of adapting systems and procedures;
- keep updating the global analysis as you undertake the exercise to ensure you are heading in the right direction;
- obtain some early review/validation of data to ensure that you've covered all areas;
- remember that you need the data to re-state the prior year as though you had always done this that the current year figures will simply show the actual in-year effect as part of ordinary reporting; and
- consider whether this could impact upon your financial assessment under the new regulatory regime.

### Registration with the Charity Commission

The Charities Act 2006 amended the law regarding the status of 'exempt' charities. Until the implementation of the Act, certain organisations that had charitable status by virtue of their rules were exempt from supervision by the Charity Commission and were not able, or required to register with them.

As a consequence of the Act, all Industrial and Provident Societies Act companies having charitable status (along with many other types of previously exempt charities) are required to register with the Charity Commission unless another 'principal regulator' could assume the

## Planning points

supervisory responsibility required under the Act. In England, the TSA was quick to act in being acknowledged as the principal regulator and hence English RSLs will not have to register.

The Wales Assembly Government has also opened up a formal dialogue with the Charity Commission and the Office of the Third Sector which it is hoped will result in 'principal regulator' status for the Assembly, negating the need for charitable Welsh I&P companies to register also.

Please be aware that at the time of writing, the Charity Commission's website suggests that all charitable Welsh I&Ps will need to register. This position could change assuming that the Assembly's position as principal regulator is ratified.