17 May 2013

Our ref: ICAEW Rep 75/13

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By email: Joseph.carr@housing.org.uk

Dear Joseph

Statement of Recommended Practice (SORP) Accounting by registered providers of social housing – Invitation to comment on the 2014 SORP

ICAEW welcomes the opportunity to comment on the consultation published by the SORP working party representing the National Housing Federation, the Scottish Federation of Housing Associations and Community Housing Cymru (collectively the SORP-making body) on 03 April 2013, a copy of which is available from this link.

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This response reflects consultation with the Social Housing subcommittee of the ICAEW Business Law Committee which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

This written response is for publication on the ICAEW website and sets out our replies to the online survey.

Consultation questions

Housing properties

1. Do you agree that guidance over the treatment of housing property tenure types as either 'Property, Plant and Equipment' or as 'Investment Properties' should be included in the SORP?

Yes. We consider that it is helpful to provide guidance for the reasons set out in the SORP.

2. If yes, do you agree with the proposed amendments in relation to housing property tenure types? If not, what alternatives would you propose and why?

Yes we agree.

Employee benefits (including pensions)

3. Do you agree that both SHPS and SHAPS should be accounted for as defined contribution schemes? If not, please give your reasons and alternative accounting treatment.

Yes we agree. Their characteristics are such that employers are affected by a surplus or deficit but are unable to identify their share of the underlying assets and liabilities on a consistent and reasonable basis. They are therefore required to account for the scheme as a defined contribution scheme under both FRS17 and FRS102.

4. Do you know of any other multi-employer pension plans where there is insufficient information on a reasonable and consistent basis available to social landlords to identify their share of the plans underlying assets and liabilities? If yes, please give details of these pension plans.

We are not aware of any other schemes fitting this description that are commonplace within the RP sector.

5. The draft SORP will require the past service cost liability for SHPS, SHAPS and other multi-employer plans that are accounted for as defined contribution plans to be recognised as a liability in the statement of financial position. What impact will this change in accounting policy have on social landlords' financial statements?

Based on the current funding position, this will lead to a reduction in net assets but an improvement in the reported surplus each year, except where there is a reassessment of the level of additional contributions required to remedy the deficit. In the event of a reassessment, there will be a change to the reported surplus in that period which could either be adverse or favourable.

However, paragraph 28.11A of FRS 102 does not require the RP to recognise the past service cost as a liability in its statement of financial position as the question implies. Instead if the RP has entered into an agreement with the multi-employer plan that determines how the RP will fund a deficit, the RP should recognise a liability for the contributions payable that arise from that agreement in the statement of financial position (to the extent that the contributions relate to the deficit) and the resulting expense in the profit and loss account.

Grant (and impact on valuation accounting)

6. For those social landlords accounting for their assets at historical cost, do you agree that the accrual model for government funded Social Housing Grant (SHG) is the most appropriate model to apply? If not, please give your reasons why, including:

a) how the performance model is a more appropriate treatment of grant; and

b) the reasons why allowing a choice between the accrual model or performance model is appropriate and will achieve consistency across the sector.

At this stage, we do not feel able to answer the question as insufficient commentary on the basis of the SORP working party's conclusion is provided.

We recognise that this is a very challenging area of accounting and one that has profound significance for RPs' financial statements. In our view, the decision on whether to apply the accrual or performance method should be based on a logical framework which summarises the purpose of the grant, the nature of the continuing obligations attached to it and the impact of the various alternative accounting treatments in the context of true and fair. Once the framework is established, the accounting treatments should then be applied consistently for all of the various situations set out in your questions 6 to 13. We consider that it is possible to reach different conclusions depending on whether housing properties are recorded at historical cost or valuation, but the logic for this difference (if applicable) should be articulated.

Apart from the single point on historical cost versus valuation where we consider a different answer might be appropriate, we recommend that a consistent approach is specified in the SORP.

The question of valuation itself needs to be thought through. In those circumstances where grant continues to be recognised as a liability, we are not convinced that EUV-SH as referred to in paragraphs 36 and 37 necessarily equates to fair value as defined by FRS 102. FRS102 section 11.28 refers to 'if there is a valuation technique commonly used by market participants to price the asset and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique'. For RPs, EUV-SH can be said to meet these criteria to some extent, although in practice there is strong evidence that actual transactions have commonly been completed at higher prices than EUV-SH. However, at the point the transactions are completed the obligations in respect of the grant transfer to the purchaser with no further consideration payable. It therefore is illogical to have the valuation already reflect the reduction in value arising from the obligation to use the property for social housing purposes at the same time as recognising a continuing liability from the grant (to the extent this has not been amortised) given that it will be extinguished entirely in the event that the disposal occurs.

This suggests that either the grant should be derecognised when a valuation basis is adopted or, alternatively, the value of the property should recognise the additional benefit to the owner of the property that would arise on disposal of the property to another RP arising from the elimination of the liability relating to grant at the point of disposal. This additional benefit would presumably have a fair value equivalent to the carrying value of the liability in relation to grant which should therefore be added to the valuation.

We recommend that the SORP working party gives this area more thought.

7. For those social landlords accounting for their assets at valuation, which of the following options do you believe is most appropriate for government funded SHG:

a) the performance model with subsequent review of impairment of the assets for which the SHG was given; or

b) the accrual model being consistent with those social landlords that hold their assets at historical cost, recognising the potential impact on net assets.

Please state your reasons. If none of the options above, please give your alternative and the reasons why this would be more appropriate. In addition indicate whether the impact of the above models would cause you to reconsider carrying property assets at valuation.

Please see our answer to question 6.

8. Do you agree that SHG should be amortised over the useful economic life of the asset's structure only? If not, please give your reasons why and alternative accounting treatment.

If the accruals method is selected, then yes we agree that the SHG should be amortised over the useful economic life of the asset's structure, except where the grant relates to another asset (eg, a component), in which case the amortisation period should be the useful economic life of that component.

9. Do you agree that RCGF should not be recognised at the point of disposal of the asset but rather be disclosed as a contingent liability? If not, give your reasons why and alternative accounting treatment.

Please see our response to question 6. If RCGF (or presumably DPF also) is not recognised at the point of disposal of the asset, it will be necessary for the SORP working party to articulate whether or not this has implications for the RP in other respects. For example, in many cases the assessed value of the new scheme in terms of financial return and social benefit will be below the RP's normal approval threshold in view of the absence of a positive cash flow from grant. Does that imply the RP has in effect accepted an onerous contract and therefore should provide for the least cost option of fulfilling the obligation? The SORP working party would also need to comment on the implications (if any) for impairment for any assets constructed using this RCGF in the absence of a positive cash flow from the grant.

However, we are concerned by the apparent inconsistency in this treatment (which effectively applies the performance method) with the ITC's earlier statement that the accruals method is the most appropriate method. It appears to be contradictory.

10. Do you agree with the accounting treatment detailed in the illustrative example of showing amortised and residual SHG as a contingent liability? If not, please give your reasons why and alternative accounting treatment. Provide an illustrative example.

Please see the responses to question 6 and 9. The illustrative example is consistent with the thought processes behind question 9. However, it would be helpful if the illustrative example was expanded to show the accounting treatment in respect of the later point at which the new property is actually completed.

Stock swaps

11. Do you agree that the fair value of the purchase price when considering stock swaps should be the EUV-SH of the properties that are acquired? If not, please give your reasons why and alternative accounting treatment?

Yes, subject to clarification of the treatment of the grant (please see the response to question 12 below).

12. Do you agree that the government grant linked to the assets swapped between social landlords should be recognised as an obligation by the receiving social landlord? If not, please give your reasons why and alternative accounting treatment. For example, do you agree with the alternative view expressed in paragraph 50?

We consider that the answer to this question needs to be derived from the process outlined in our response to question 6. However, we do note the apparent inconsistency between the proposed treatment of a stock swap in which it is proposed that the grant is being recognised following the transaction and the treatment of RCGF in which it is not.

Notwithstanding, if the grant is to be recognised, then we consider it would also fall within the definition of cost of the property and therefore should be capitalised. This would therefore alter significantly the balances recorded in the illustrative example. However, consideration needs to be given to the amount at which the recipient RP should recognise the grant that attaches to the property transferred in. It could be the full amount (including that previously released to income by the transferor RP) or it could be the balance of the grant not previously so released. We recommend that the SORP clarify the amount to be taken into account if the Working Party decides to require recognition of the obligation.

13. Do you have a view on the wider implications of the treatment proposed by the SORP Working Party in paragraph 49, for example on the treatment of grant in consortium and/or inter-company transactions?

We consider that this complex question requires greater articulation of the framework (as discussed in our response to question 6 above).

Agreements to improve existing properties

14. Are you of the view that guidance over the treatment of agreements to improve existing properties should be amended in the SORP to comply with FRS 102 and ensure that agreements to improve existing properties are recognised on a gross basis?

Yes.

15. If yes, do you agree with the proposed amendments in relation to agreements to improve existing properties? If not, why not and what alternatives do you support (with reasons)?

Yes, we agree with the proposed amendments.

Financial instruments

16. Do you agree that the SORP should not repeat Section 11 or Section 12 in relation to financial instruments, but rather clearly reference FRS 102 and provide a technical note? If not please explain your reasons.

Yes. We expect a number of RPs to apply the recognition and measurement provisions of IAS39 and therefore it would be helpful if some guidance were also provided to assist RPs if they elect this option.

17. The technical note to the SORP is intended to provide worked examples of how to account for common financial instruments that social landlords have. What are the common financial instruments social landlords have which should be included in the technical note?

We have not separately researched this area so feel unable to comment. However, we would like to draw to your attention to a comment that we made in relation to the consultation on the new HCA Direction where we expressed the view that disclosures on financial instruments were generally insufficiently consistent and inadequate. We suggest a framework of minimum disclosures as follows, and recommend that the SORP working party includes these requirements in the SORP for consultation:

- the level of available facilities split between immediately available and those for which are confirmed but subject to conditions which have not yet been fulfilled, together with an overview of the periods the facilities are available for;
- the fair value of loans and derivatives at the start and end of the period compared to book value;
- the level of security pledged on out of the money instruments;
- the proportion of fixed/floating security;
- the loan profile in terms of due dates; and
- the level of unsecured properties.

To ensure consistency of pronouncements, we shall recommend to the HCA that these disclosures be made mandatory when the Accounting Direction is next updated.

Transitional arrangements

18. Do you agree with the key changes to accounting policies considered in this ITC? If not, what other key changes do you believe should be considered separately by the SORP Working Party?

Yes.

19. Do you agree that other changes to accounting policies, changes to terminology and changes to the presentation and disclosures are best addressed in a 'transitional' section of the revised SORP? If not, please give your reasons why and alternative suggestions.

Yes.

20. Are there any exemptions in paragraph 35.10 of FRS 102 that you believe should not be available to social landlords? If so, please give your reasons why and alternative treatment.

We consider that all of the exemptions should be available to social landlords, although in practice only a restricted number are likely to be applicable.

Narrative reporting

21. Do you agree that there is value in narrative reporting as part of the financial statements beyond the requirements of statute, for example the Companies Act?

Yes we do consider that there is potential value from narrative reporting although we are sceptical about whether that value is currently being achieved due to the length of relatively unhelpful text in some RPs' financial statements and the general tendency for positive aspects of performance to be given more emphasis that negative ones. However, these observations are not a feature unique to the RP sector.

22. Do you agree that all social landlords with more than 5,000 homes in management should prepare an OFR? If not, please provide an alternative threshold or state the reasons why you believe an OFR should not be required.

Yes, although we suggest an exemption should be granted for RPs with more than 5000 homes in management which are a subsidiary of another RP which produces an OFR in its group accounts.

23. Do you agree with the current reporting requirements of an OFR, including the required headings that are to be included in an OFR? If not, provide those headings that you believe should be required.

It is very difficult to establish a consistent framework for narrative reporting given the wide range of different business models operating in the sector. Our suggestion is that the OFR headings should be largely focussed on what the RP considers internally to be its main objectives and how the RP itself measures its own performance. The SORP working party could also usefully establish a small number of areas that the RP should consider commenting on, as guidance, but articulate the key objectives for narrative reporting for RPs rather than specify the subjects they should cover.

Adoption date

24. Given the timescales outlined in paragraph 66 above do you plan to early adopt the new SORP based on FRS 102 for the year ended 31 March 2015. If yes, please state your reasons.

This question is not applicable to the ICAEW but we are not presently aware of any RPs who may consider early adoption. The only situation where we consider early adoption likely is by a new RP preparing their first set of accounts.

Yours sincerely

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