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Our ref: ICAEW Rep 31/14

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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 is pleased to respond to your request for comments on *Statement of Recommended Practice (SORP) Accounting by registered providers of social housing – Invitation to comment on the 2014 SORP*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

STATEMENT OF RECOMMENDED PRACTICE (SORP) ACCOUNTING BY REGISTERED PROVIDERS OF SOCIAL HOUSING – INVITATION TO COMMENT ON THE 2014 SORP

Memorandum of comment submitted in February 2014 by ICAEW, in response to National Housing Federation consultation paper Statement of Recommended Practice (SORP) Accounting by registered providers of social housing – Invitation to comment on the 2014 SORP published in November 2013

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INTRODUCTION

1. 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 14 November 2013, a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world leading professional membership organisation that promotes, develops and supports over 142,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession. As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.
5. 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.
6. This written response is for publication on the [ICAEW website](#) and sets out our replies to the online survey.

KEY POINTS

7. We are very concerned that the proposals for the measurement of recoverable amount as a basis for impairment of assets will have a significant adverse impact on the financial statements of registered providers. SORP 14 will rule out the concept of planned internal subsidy allowed for in the 2010 SORP and implies instead that an external valuation will be required in many cases. The impact of the change could be that decisions made in the past with a benign accounting consequence for an individual housing association will now be reflected in the accounts in a way that potentially jeopardises the future existence of the entity because of either the reduction in carrying value of the housing assets concerned or the impact on the income statement. It is possible that the scale of this issue for some social landlords might trigger a level of impairment that leads to covenant breaches, a repricing of debt, or at least a reluctance to continue developing at the levels previously anticipated.
8. We understand that this point was discussed in detail by the SORP working party with the Financial Reporting Council (FRC) during the process of putting together the draft SORP 2014 and that the FRC indicated that they were uncomfortable with the self-assessment process set out in SORP 2010. We agree that the self-assessment process is unreliable, likely to be applied inconsistently and is open to abuse and therefore should be discontinued. We also agree that impairment testing should be as rigorous and standardised in the social housing sector as in any other.

9. However, we do not agree with the comments in 14.17 of the exposure draft where it suggests that measurement of assets held for their service potential will need to occur only in 'rare circumstances', implying this method is not appropriate for most such assets. There is no statement in FRS 102 to the effect that section 27.20A of FRS 102 cannot be applied for assets that are capable of being valued for fair value purposes or which benefit from cash inflows from their use. Consequently this section (27.20A) should be applicable to any asset used for social housing as long as its primary purpose is social benefit, even if it both has a value that can be assessed reliably and generates cash inflows.
10. Furthermore, the exposure draft only comments on this crucial section in the negative, implying that depreciated replacement cost (DRC) is not appropriate. It does not provide any guidance as to how section 27.20A can be applied. Given that DRC is explicitly referred to in 27.20A as a possible option, this approach is perverse. To repeat, the fact that a fair value can be estimated for an asset is no ground for dismissing DRC for the purposes of assessing impairment; it is of course strong grounds for not permitting DRC to be used as a valuation method in the financial statements under the revaluation model set out in section 17.15B of FRS 102, but that is something completely different and irrelevant in the context of impairment. On the contrary, we consider that depreciated replacement cost (or a variation on that theme) is the most appropriate method for assessing the section 27.20A value in use for assets held for their service potential. This is best derived from estimating the market value of the asset (in effect its replacement cost via the open market), less estimated available grant (to derive the net cost to the registered provider), less an allowance for the asset's condition (in the form of an estimated depreciation amount).
11. In short, we consider it essential that the SORP both confirms that 27.20A is applicable to social housing assets and that the SORP gives guidance on the application of 27.20A to the measurement of recoverable amount whilst assessing potential impairment of social housing assets.

General comments: duplication with FRS 102

12. Quite a lot of the text in the draft SORP is of general application so does not provide guidance on the special considerations in preparing accounts for registered providers of social housing. Section 2 in particular is mainly a repeat of the concepts and principles set out in FRS 102. However, there is duplication of material from FRS 102 throughout the document. We recommend that these duplications be deleted: this would make the SORP much shorter and focused better on points that are difficult or contentious.

General comments: matters not covered sufficiently

13. It would be helpful if the SORP clarified a number of matters that are likely to be relevant to RPs' financial statements where FRS 102 does not presently provide any specific guidance. For example, what disclosures should an RP consider making under FRS 102 paragraphs 8.6 and 8.7 in relation to judgements and sources of estimation uncertainty? Although we recognise that different RPs will have different points to make under these two paragraphs, for many RPs there will be some similarity which would be helpful for the SORP to comment upon.
14. Whilst the SORP should not be prescriptive on points of detail, there are areas where the range of choice should be narrowed. There needs to be guidance on, for example:
 - Whether operating surplus is a required reporting line
 - If so, whether amortisation of grant should be above or below operating surplus
 - Where to show the credit arising on the write-back of any impairment
 - Where to show any profit on disposal of assets
 - Where to show gains or losses on fair value movements on financial instruments
15. One specific area of accounting affecting many housing associations is in relation to HomeBuy transactions. There are a number of variations to HomeBuy which includes similar arrangements to shared ownership, for which the accounting treatment is clarified in the

exposure draft. However, there are also some variations to the shared ownership model which are not articulated in the exposure draft and some HomeBuy arrangements which have very distinct features. We suggest that further research is undertaken to assess these variations to conclude whether more specific guidance on their treatment should be included in the SORP.

16. A second specific area refers to public benefit entity (PBE) concessionary loans set out in FRS 102 paragraph PBE 34.87. The circumstances when the concessionary loan accounting policy can be applied should be articulated in the context of housing associations. It is quite common for housing associations to lend money to other group members or be lent money by other group members, where the rate specified in the loan agreement is either zero or below market rate. Paragraph PBE 34.87 specifies that the concessionary loan arrangements are not applicable to loans made under commercial arrangements. We therefore consider that ordinarily intra-group loans of this kind would not be able to apply the concessionary loan accounting treatment unless the below-market-rate of interest was specifically set in order to facilitate the ability of the borrower to perform its activities of a PBE nature, and was not required at the point it was advanced in order to help reduce financial pressures on the entity that existed at that point in time.
17. A third area concerns properties acquired by one RP from another. The specific example on a stock swap provided in the Exposure Draft indicates that grant is de-recognised in the event of a swap. We consider that the SORP should clarify the treatment in the parallel situation of one RP purchasing social housing properties from another RP and that the treatment should be analogous; in other words, that similarly the grant received by the seller should be de-recognised when the asset is recorded by the purchaser.
18. A fourth area relates to the very specific situation applicable in England where the right to charge higher rents on some existing properties is included in a contract with the Homes and Communities Agency provided that the RP delivers a specified number of units of additional social housing. We consider that this contractual right is an intangible asset which is capable of measurement (both the social rent and the higher rent are reasonably predictable) should be recognised as an intangible asset under 18.2(b) of FRS 102. Given that this is a relatively new concept, it would be helpful for the SORP to articulate this.
19. Finally, the example primary statements include several inconsistencies or inaccurate phrasings and should be reviewed. For example, there is presently no row for operating costs, there are two rows for surplus after tax and surplus for the year (is there a difference?), interest and financing costs are shown as just one line which implies incorrectly that credits and debits can be netted off, and the heading 'change in fair value of hedged financial instrument' is not appropriate for the most common hedging arrangement, cash flow hedges.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Overall presentation of the SORP

Q1. Is there any section of FRS 102 that is not addressed in the SORP on which you feel additional guidance or interpretation is needed for the social housing sector? If yes please explain in the comment box.

20. Yes, we have commented more fully on these points above.

Section 1 of the SORP: Introduction

Almshouses and similar organisations have indicated that the charities SORP would be more applicable to their business than the housing SORP and therefore have asked the SORP Working Party to consider whether an exemption can be included in the SORP to permit this. This is included in the SORP at paragraph 1.4.

Q2. Do you agree with such an exemption being included in the housing SORP? If no, please explain in the comment box below.

21. Yes.

Section 3 of the SORP: Presentation of financial statements

Paragraph 3.8 of the SORP restricts the choice of presentation of a social landlord's income and expenditure and requires this to be presented as a single Statement of Comprehensive Income. This has been done to ensure greater consistency across the sector on how financial statements are presented. It also reflects the fact that, for some registered social housing providers, the movements through reserves can be substantial when compared to operating activities, requiring the income and expenditure account to be read in conjunction with the statement of recognised gains and losses and reserves note for the reader to have a full understanding of the results for the period.

Q3. Do you agree with the restriction set out in paragraph 3.8 of the SORP to only permit a single Statement of Comprehensive Income in the presentation of a social landlord's income and expenditure? If no please explain in the comment box below.

22. Yes, we agree with the proposal for the reasons set out in the consultation document.

Section 4 of the SORP: Narrative reporting

Section 4 of the SORP sets out the requirements for narrative reporting and includes high level guidance on the principles to be followed in presenting a business review which are consistent with the new strategic reporting requirements of the Companies Act 2006. The guidance is significantly shorter than that set out in the previous SORP to allow greater flexibility and freedom in how this information is presented.

Q4. Do you agree with the principle that the SORP provides high level guidance on the content of a business review rather than prescribing the information and the format of the narrative reporting to be included in the financial statements? If not, please explain what additional guidance is required in the comment box below.

23. Yes. We agree that it is sensible to align with the new Companies Act requirements, as proposed.

Q5. Do you consider there is any further information on narrative reporting that social landlords should be required to include in their financial statements which is not set out as a requirement in the SORP?

24. No.

Section 6 of the SORP: Financial instruments

Q6. Does Section 6 of the SORP provide sufficient guidance to understanding the general principles and requirements of Sections 11 and 12 of FRS 102? If no, please provide suggestions on further guidance needed in the comment box below.

25. For the reasons set out above, we are not convinced there is any advantage to the SORP repeating the general themes already set out in the FRS. Our preference would be that the section is considerably shortened or alternatively removed.

Section 8 of the SORP: Housing properties

Following the ITC in April 2013, the majority of respondents indicated that the SORP needed to include guidance on the considerations to be applied in categorising properties as either property, plant and equipment or investment properties but that the guidance should not be too prescriptive. In addition, a number of respondents requested that a definition of 'held for social benefit' was included in the SORP. Section 8 of the SORP has been drafted to provide guidance based on the key principles to be applied when categorising properties

which are based on the intended use of the property. The SORP Working Party has debated including a definition of 'held for social benefit' within the SORP. This term is not defined in FRS 102 and the key concern of the SORP Working Party was that any definition drafted would be too narrow and risk being too prescriptive. As a result no such definition is included.

Q7. Do you agree with the conclusion of the SORP Working Party that defining 'held for social benefit' will risk being too narrow and prescriptive in terms of what should be classified as property, plant and equipment and will not be able to take account of the various different tenure types in the housing sector currently and in the future?

- 26.** Yes. Section 8 has some useful guidance phrased around intended use. The shared ownership accounting guidance is the same as in the current SORP and is needed, as is the mixed tenure accounting guidance (also unchanged).
- 27.** However, we recommend that some of the text on mixed tenure development schemes be reviewed. In 8.40, the exposure draft repeats similar text to that in the 2010 SORP in relation to mixed tenure schemes. It currently states: 'Where a social landlord has a **mixed tenure development scheme** which is evaluated as a single scheme but has more than one element, a social landlord should assess the income and expenditure for the scheme at an overall scheme level. If one element of a mixed tenure development scheme is expected to generate a surplus and another element shows a fair value below cost, it is not appropriate to recognise the entire surplus on one element of the scheme and the surplus should be reduced by the shortfall between fair value and costs. In these circumstances any grant funding received for the scheme should be included within the calculation of the overall profit or loss of the scheme'. In 8.41, it further comments: 'This is applicable to all mixed tenure development schemes where surpluses from one element of the properties may be used to cross-subsidise the element of the scheme retained for social housing. It should be applied for the purposes of group consolidation where the development of different elements of the scheme takes place in different group entities'.
- 28.** In view of the evolution of more complex schemes and, in England, changes to capital funding from the Homes and Communities Agency such that there is more inter-dependency on a range of schemes for funding purposes, we consider this text should be refreshed. In particular, it would be sensible to refer to this as 'cross subsidy accounting' as opposed to 'mixed tenure development schemes' since the principles should apply equally where there are several schemes involved where some are cross-subsidising others. The phrase 'income and expenditure' in this context is capable of being misinterpreted and would be better phrased as 'the expected value and costs', with the additional specification that value should be derived from the grant receivable or received, expected sale proceeds (where that part is intended to be sold on or shortly after completion), market value (where the item is held for rental but is not a social benefit asset) or EUV-SH (where the item is social housing).

Section 11 of the SORP: Recycling of grants

Q8. Do you agree with the principles set out in paragraphs 11.13 to 11.16 of the SORP in relation to the recycling of grants? If no, please explain why not and provide suggested alternative treatment in the comment box below.

- 29.** We agree with the principles. However, the wording of Section 11 implies that the Recycled Capital Grant Fund balance should be recorded as a provision until it is applied. We think this is wrong. The quantum and timing of the amount repayable are known so it should be classified as a creditor. In other respects we agree with principles outlined in paragraphs 11.13 to 11.16 of the SORP.

Q9. Is the worked example accompanying this section of the SORP sufficiently clear to explain how such transactions must be accounted for? If no, please explain why not in the comment box below.

30. Yes: the worked example is accurately recorded and is helpful.

Section 13 of the SORP: Grants

In drafting the SORP, the SORP Working Party concluded that in order to drive consistency across the sector the model to be applied in recognising government grant should be mandated in the SORP.

Paragraph 13.7 of the SORP requires that the accrual model is applied for social landlords holding their housing property at cost and the performance model is applied for social landlords holding their housing property at valuation.

The SORP Working Party believe that this provides the most appropriate accounting treatment, reflecting the difference circumstances relevant to social landlords who hold housing properties at cost and those who hold housing properties at valuation.

Q10. Do you agree with the approach taken in the SORP for accounting for government grant?

31. Yes, the proposed accounting treatment will help with consistency.

Do you have any comments?

32. The worked examples are helpful.

Q11. An alternative approach would be to allow a choice of accounting treatment as set out in Section 24 of FRS 102 and leave it up to individual social landlords to make a choice over accounting for government grant using the accrual model or performance model regardless of their accounting policy for housing properties. To allow a complete choice will lead to a greater degree of accounting inconsistency in the sector. Do you believe this alternative approach is more appropriate for the housing sector?

33. No.

Do you have any comments?

34. We agree with the SORP working party that the benefits of consistency should be the main driver for this judgement.

35. FRS 102 states that 'grants relating to assets shall be recognised in income on a systematic basis over the expected useful life of the asset' (24.5F). The SORP sets out, in paragraphs 13.15, 13.16 and 13.17 how this has been interpreted for government grants received by a social landlord, ie, the grant should be recognised over the life of the related assets. Furthermore, the SORP states that where a government grant is provided for a housing property (rather than a specific component) it should be recognised over the expected useful life of the structure of the property. The interpretation needs to be expanded to cover the treatment of grants in relation to shared ownership schemes, for example where the structure is not being depreciated due to high residual value, and HomeBuy loans.

36. So far as allocation of grant is concerned, paragraph 13.18 of the exposure draft states that 'in the case of grants received specifically for components of a housing property, for example where a social landlord receives funding for replacement of boilers, the grant should be recognised in income over the expected useful life of the component.' We agree with this approach. In 13.17, the specification is that 'grants received for housing properties should be recognised in income over the expected useful life of the housing property structure (not land and structure), even if the fair value of the grant exceeds the carrying value of the structure in

the financial statements.' We agree with this approach also. However, to avoid any ambiguity on this point and ensure consistency, and given in particular the interpretation that some housing associations are considering applying, we suggest it is worth emphasising in 13.17 that unless the grant advanced was specifically required to be spent solely on a given component then it must be allocated to the structure. The mere presence of an excess level of grant over and above the cost of the structure does not permit the allocation of the grant to components.

Q12. Do you agree with the approach taken in the SORP in amortising government grant for housing properties over the useful economic life of the property's structure?

37. Yes.

Q13. If not, do you agree with the alternative approach of a composite amortisation rate based on the structure and individual components of the housing property?

38. N/A.

Do you have any comments?

39. No.

Section 14 of the SORP: Impairment

The guidance for impairment has been updated to ensure consistency with FRS 102 and as a result the concept of planned internal subsidy as set out in the 2010 SORP is not included in this SORP and can no longer be applied when assessing impairment.

Q14. Is further guidance required for the measurement of recoverable amount?

40. Yes.

Do you have any comments?

- 41.** This particular proposal is causing considerable consternation amongst some RPs. Since the change in treatment is potentially very material to some RPs, it will be important that the potential for differences in interpretation is minimised. We anticipate considerable practical difficulties with a judgement of this kind, dependent as it will be on a range of uncertain estimates, when the assessment may well prove to have a pivotal role in whether or not the RP has complied with its covenants or is able to commit to developing future social housing properties. We consider that there are fundamental difficulties with this proposal and recommend that the FRC discuss alternative approaches with sector representatives.
- 42.** For the reasons articulated above, we suggest that the starting point for the discussion could be consideration of paragraph 27.20A of FRS 102 and its application to RP social housing properties. The paragraph states:
- For assets held for their service potential, a cash flow driven valuation (such as value in use) may not be appropriate. In these circumstances value in use (in respect of assets held for their service potential) is determined by the present value of the asset's remaining service potential plus the net amount the entity will receive from its disposal. In some cases this may be taken to be costs avoided by possession of the asset. Therefore, depreciated replacement cost, may be a suitable measurement model but other approaches may be used where more appropriate.
- 43.** We consider that this is particularly relevant to RPs because the primary reason for holding properties is for their service potential.
- 44.** At the moment, the exposure draft rather dismisses value in use on the basis that it ordinarily will result in a lower figure than EUV-SH. This is correct but implies that there is limited value in performing a value in use despite the fact that this will usually be much easier for the RP to

undertake (given it is derived from the RP's own largely predictable cash flows) compared to an EUV-SH valuation (which requires knowledge of recent market transactions, amongst other things). It would be more sensible to change the phrasing to emphasise that value in use is likely to be the first port of call for many impairment assessments, but EUV-SH can in most cases be expected to be higher than value in use. In addition, value in use for assets held for their service potential should also be considered.

- 45.** The exposure draft currently states in 14.11 that 'in most circumstances a cash generating unit is best represented by an individual scheme at the level where investment appraisals are carried out by a social landlord'. In our view this is not the appropriate level to set cash generating units since how the scheme was originally appraised is not relevant or consistent with the definition of cash generating units within FRS 102. We consider that the more appropriate level is individual unit by unit, but that for practical purposes, housing associations should be able to argue that a scheme with consistent features is unlikely to have some units impaired whilst others are not and therefore the assessment can be reliably performed at a scheme level. However, if there is an indication within a scheme that part of the scheme is not performing as well as other parts (for example, three bed units are proving difficult to let whilst two bed units are fine, or a selection of units close to a railway line are proving hard to let, or there is a mix of different types of tenure, say shared ownership, rental and outright sale), then the cash generating unit needs to be set at a lower level accordingly. For emphasis and to achieve greater consistency, we recommend that the SORP makes explicit that how schemes were approved or managed has no part to play in assessing the level at which the cash generating unit should be set.

Q15. Do you agree with the inclusion of unamortised grant when calculating the carrying amount of housing properties as set out in paragraph 14.19 of the SORP? If not, please explain why not.

- 46.** Yes. The wording of the question is slightly confusing but based on the assumption that the reference is to the deduction of unamortised grant from the net book value of the scheme in question, the proposed treatment is consistent with IAS 36 paragraphs 76 and 78.

Do you have any comments?

- 47.** No.

Section 16 of the SORP: Related party disclosures

FRS 102 requires that transactions and balances with related parties are disclosed in the financial statements and the fact that transactions are conducted on an arm's length basis does not permit such transactions to be exempt from disclosure. This means that transactions and balances with related parties such as tenant board members will have to be disclosed in the financial statements. Paragraph 16.6 of the SORP sets out this requirement, and advantage has been taken of the provision in FRS 102 to allow transactions of a similar nature to be disclosed in aggregate which means transactions with tenant board members can be disclosed in aggregate rather than individually.

- 48.** There is no question here. However, we agree with the proposed treatment.

Section 17 of the SORP: Stock swaps

The responses to the ITC in April 2013 indicated a general consensus that the fair value of stock in a stock swap transaction was EUVSH. In discussing the method of EUVSH with the sector's valuers (as set out under Section 14: Impairment of the Consultation Questions) it is noted that EUVSH does take into consideration the terminal value of the government grant obligation associated with housing properties when they are sold or transferred. Therefore, whilst the government grant does transfer with the housing properties in a stock swap transaction, there is no separate accounting entry to recognise this grant on the

balance sheet as EUVSH has been determined as the fair value of social housing properties and this includes the present value of expected future cash outflows arising due to grant. The SORP requires disclosure in the notes to the financial statements of details of the stock swap transaction including the government grant obligation transferred with the housing properties.

The accounting requirements for stock swaps are set out in paragraphs 17.15 to 17.19 of the SORP.

Q16. Do the paragraphs above provide clear guidance on the accounting for stock swap transactions?

49. Yes.

Do you have any comments?

50. Section 17 comments very briefly on concessionary loans without expanding on the objective 'to further the objectives of the public benefit entity' in the RP context. As discussed above, it would be helpful if the section were expanded to include some thoughts on how an RP should judge whether or not a loan falls within that requirement. Also as discussed above, references to 'EUV-SH' will need to be revised if our recommendation that an alternative basis for impairment measurement is agreed.

Q17. Does the worked example that follows these paragraphs make it clear how it is expected that such transactions would be reflected in the financial statements? If not please explain any additional guidance that is required for accounting for stock swap.

51. Yes.

Do you have any comments?

52. The stock swap example is helpful and accurate. The key point here is the treatment of the grant and that it is not recognised following the transaction. This appears to be consistent with the performance model being applied in situations where the balance is recognised on the basis of a link with EUV-SH (subject to our comments on questions 14 and 16 above).

OTHER COMMENTS

53. Section 8: Another point that needs to be addressed concerns the proportion of value of a housing property carried at valuation that is attributable to land. This clearly has significant repercussions for the depreciation charge recorded by the RP but is not covered by any guidance in the SORP. Although this could be regarded as a matter for the valuers to opine upon, it would be helpful for the SORP to set out the basis for the evaluation given that the land and building are both dependent on each other for value to be derived and therefore it is hard to establish a separate value for either.

54. Section 10 introduces a new requirement to the effect that standard rental agreements and relationships between RPs where one owns and the other uses a property also comprise leases. This seems correct.

55. Section 12 does not specifically comment where grant amortisation should be recorded in the income statement. It would be helpful for consistency purposes if it either specified this should be recorded in turnover, other operating income or in other income (below operating surplus) depending on which is the preference. The same point applies to grant treated under the performance model.

56. On a general point, it would be helpful if the SORP contained guidance on drawing up the opening balance sheet for making the transition from cost to valuation model.

57. We note that there are some minor typographical errors in the Exposure Draft and assume that these will be identified and corrected when the document is revised following the consultation.

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