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By email to: joseph.carr@housing.org.uk

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Dear Mr Carr

Housing SORP consultation

Deloitte LLP is pleased to respond to Housing SORP consultation. We have set out our detailed responses to the consultation questions in the Appendix to this letter.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions, please contact Ken Rigelsford on 020 7007 0752 or krigelsford@deloitte.co.uk.

Yours sincerely

Veronica Poole
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Deloitte LLP

Appendix

Responses to detailed questions

Question 1 This SORP provides interpretation and guidance to registered providers of social housing on specific areas of the financial statements that are either not included explicitly within Financial Reporting Standard 102, or require additional guidance and interpretation for the social housing sector. The SORP does not reproduce the requirements set out in FRS 102, and therefore provides signposting to specific sections of FRS 102 throughout.

1. 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?

Yes.

Do you have any comments?

We recommend that the SORP includes some general guidance on where certain balances should be presented in the Statement of Comprehensive Income, for example the amount of grant that has been recognised or amortised.

Additionally, we note that the SORP repeats many of the requirements of FRS 102 and recommend that it only include the relevant material that is specific to the social housing sector. Whilst we appreciate that some users would prefer to have all the applicable requirements (which would include the FRS 102 requirements) in one document, we believe that a more concise document which references to the relevant requirements of FRS 102 instead of repeating them would be more practical.

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.

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

Yes.

Do you have any comments?

We agree the exemption should be included in the housing SORP.

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.

3. 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.

Yes.

Do you have any comments?

We agree with the restriction set out in the SORP and the reasons given in the consultation paper.

Following the Invitation to Comment (ITC) issued in April 2013, the majority of responses agreed that there was value in including narrative reporting as a requirement in the SORP and supported the requirement for social landlords with more than 5,000 homes in management to include an Operating and Financial Review (OFR) in their financial statements.

However, the majority of respondents to the ITC agreed with the guidance set out in the SORP 2010 for preparing an OFR. There has now been a change to the reporting requirements for companies, with the introduction of strategic reporting, alongside a directors' report, and the SORP Working Party concluded that the narrative reporting requirements of the SORP should be updated to reflect these changes and, in doing so, provide social landlords with greater flexibility in the way they include narrative reporting in their accounts.

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.

4. 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.

Yes.

Do you have any comments?

No comments.

5. 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?

We have considered the requirements within the SORP and have not identified any further information to be included in the financial statements.

The responses to the ITC in April 2013 agreed that the financial instruments sections of FRS 102 (Sections 11 and 12) should not be repeated in the SORP.

6. 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.

Yes.

Do you have any comments?

We suggest that section 6 should be removed as the requirements in the SORP are the same as FRS 102 and there is no additional benefit in repeating them. We believe the industry is aware of the requirements of FRS 102 around financial instruments and have been anticipating the changes that would be needed. Furthermore, we are aware that Sections 11 and 12 of FRS 102 will be updated imminently and if included here, the SORP will need to be updated to reflect this.

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.

7. 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?

Yes.

Do you have any comments?

We agree 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. In particular we believe by excluding a definition, social landlords are encouraged to provide more disclosure of their operations in their financial statements, which in turn will increase transparency.

Following the ITC in April 2013 the responses received in relation to the issue of recycling of government grants indicated that many social landlords considered this to be a liability at the point of disposal of the asset as this was the point at which there is an obligation to recycle or repay the government grant. Paragraphs 11.13 to 11.16 of the SORP set out the accounting requirements for the recycling of grants.

8. 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.

No.

Do you have any comments?

We disagree that the recycling of grants should be treated as provisions. We believe that they should be disclosed in a manner that is consistent with when they are repayable if repayable i.e. a long term liability when due after more than one year and a current liability when due in less than one year. Outside of the classification point above between provisions and creditors we have no further observations and agree with the principles.

9. 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.

Yes.

Do you have any comments?

We have found the example to be clear. However, consistent with question 8 we believe the recycled grant should be classified as a creditor and not as a provision.

There has been significant debate across the housing sector on the treatment to be applied in accounting for government grant. In the ITC issued in April 2013 the question was raised over whether the accrual model for grant accounting should be required for those holding housing properties at cost and the majority of respondents agreed with this principle. There was less agreement in respect of those holding housing properties at valuation and how to apply the accounting requirements for government grants set out in FRS 102.

The majority of government grant received by social landlords is to assist in the cost of development of their housing properties and therefore there is an ongoing linkage between housing properties and government grant.

Where housing properties are recognised at cost rather than valuation the accrual model for recognising the associated grant reflects the substance of the overall transaction as the grant is matched to the life of the underlying asset.

Social housing grant is partly intended to compensate for the fall in value that often occurs when a property is constructed and then applied for social housing purposes. Where housing properties are measured at valuation this extinguishes the linkage between the housing property and the grant. Consequently, using the performance model where properties are held at valuation is considered most appropriate as the outcome of the fall in value for which the grant is compensating has already been reflected in the valuation. As a result it is considered that applying the accruals model and carrying forward the unamortised grant as a liability in these circumstances would appear to be double counting.

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.

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

Yes.

Do you have any comments?

We agree with the approach taken in the SORP for accounting for government grants. We appreciate there may be some hesitance among industry participants in terms of the technicalities of applying FRS 102 but we agree this is the most appropriate approach. Historically, we have noted the repayment of grants is very rare and hence the recycling is a very common aspect in this industry.

11. 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?

No.

Do you have any comments?

We believe an alternative approach is unnecessary as it would lead to social landlords adopting a hybrid approach, which will exacerbate inconsistency in the sector.

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'. 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, i.e. 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.

An alternative to this method would be to apply a composite amortisation rate to the grant taking into account the structure and individual components of the housing property.

12. 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?

Yes.

Do you have any comments?

We agree with the approach taken in the SORP but it should clarify that this approach applies only to general needs property grants. The SORP should also address other forms of grants such as 'Homebuy' which have not historically been amortised because they are not grants related to assets and this should be made clear.

13. 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?

No comment.

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.

It is recognised that, whilst there are cash flows associated with social housing properties, these assets are not held to generate a financial return but rather to provide a social benefit and therefore the SORP Working Party has deliberated over the most appropriate model to measure the recoverable amount. In particular, discussions considered different methods that could be used to determine an asset's service potential and that would be consistent with the requirements of paragraph 27.20A of FRS 102. In discussion with the sector's valuers the SORP Working Party concluded that depreciated replacement cost is not an appropriate measurement model for recoverable amount and would only be relevant to highly specialised assets for which no market value can be determined, which are considered to be rare. In measuring the recoverable amount FRS 102 states that this is the higher of fair value less costs to sell and value in use. The SORP Working Party has concluded that fair value in these circumstances can reasonably be determined as existing use value for social housing (EUV-SH) based on the information obtained from the sector's valuers. The EUV-SH calculation should be carried out by a professionally qualified valuer and should reflect the outcome of market transactions, i.e. the value at which social housing properties have been transacted within the sector between social landlords.

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

Yes.

Do you have any comments?

Paragraphs 14.14 to 14.17 of the draft SORP do not address this issue adequately. They appear to suggest that ordinarily EUV-SH will be the best indicator of recoverable amount. However, EUV-SH is defined to mean the price at which a transaction would take place in social housing and such transactions are relatively rare in practice. We believe it is likely, given the way in which EUV-SH is currently interpreted by valuers, that adoption of this method to calculate recoverable amount would lead to frequent impairment write downs in circumstances when this would not be appropriate.

Paragraph 14.17 of the draft SORP acknowledges that the recoverable amount of an asset held for its service potential should, in accordance with paragraph 20.20A of FRS 102, be determined by reference to the present value of the asset's remaining service potential (i.e. not just cash flows) plus the net amount the entity will receive from its disposal. However, we are unclear why this paragraph refers to this being relevant only in rare circumstances. Although social housing assets do generate cash flows they are also held to provide public benefits and any calculation of value in use should recognise this additional service potential. We realise that quantification of such public benefits on a consistent basis presents challenges but it is necessary for such benefits to be taken into account to avoid inappropriate impairments being recognised.

The National Housing Federation should discuss these issues again with the FRC and valuation experts and develop a solution which does not impose an excessive cost burden on social housing providers and results in recognition of impairment only in circumstances when to do so would be consistent with giving a true and fair view of the entity's performance in the period.

Under the 2010 SORP where tangible fixed assets are carried at cost, social housing grant (as well as depreciation) is deducted from the carrying value of the asset to arrive at the asset's net book value. Where assets are presented at valuation, the only deduction is for depreciation since the last valuation date.

In changing the accounting and presentation of government grants to be consistent with FRS 102, government grants will now be presented within liabilities on the balance sheet and either amortised to the Statement of Comprehensive Income over the life of the housing property structure (if the property, plant and equipment is measured at cost) or recognised as income once performance conditions have been met (if the property, plant and equipment is measured at valuation).

As a result of this the carrying value of grant is no longer deducted from the carrying value of the property, plant and equipment when reaching the net book value. Although this makes no difference to property, plant and equipment carried at valuation, the carrying amount of property, plant and equipment carried at cost will be higher as a result and the question raised was whether an impairment loss would need to be recognised purely because of this presentational change.

FRS 102 is silent on the inclusion of liabilities (i.e. grant in these circumstances) in the assessment of impairment. It establishes the general principle that if, and only if, the recoverable amount of an asset is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its recoverable amount.

Paragraph 10.6 of FRS 102 allows entities to consider EU-adopted IFRS in making judgements and the SORP could incorporate some of the additional guidance in IAS36 on that basis.
Paragraph 76 of IAS36 states:

"The carrying amount of a cash-generating unit (CGU):

a) Includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the CGU and will generate the future cash inflows used in determining the CGU's value in use; and

b) Does not include the carrying amount of any recognised liability, unless the recoverable amount of the CGU cannot be determined without consideration of this liability."

However, paragraph 78 goes on to state:

"It may be necessary to consider some recognised liabilities to determine the recoverable amount of a CGU. This may occur if the disposal of a CGU would require the buyer to assume the liability. In this case, the fair value less costs of disposal (or the estimated cash flow from ultimate disposal) of the CGU is the price to sell the assets of the CGU and the liability together, less the costs of disposal. To perform a meaningful comparison between the carrying amount of the CGU

and its recoverable amount, the carrying amount of the liability is deducted in determining both the CGU's value in use and its carrying amount".

This suggests that a liability can be included in the consideration of the carrying value if a buyer was required to assume the liability on acquisition. Equally, if the liability is not transferring then (per IAS36) the carrying value needs to be assessed without taking into account the grant.

Following discussions with valuers, the SORP Working Party has determined that EUV-SH calculations include consideration of the market value of social housing properties in market transactions and therefore do incorporate the expected cash outflow in relation to the grant obligation or liability linked to the housing properties being sold. Therefore, in order to ensure comparability, it would appear logical to deduct the grant from the cost of the property, plant and equipment in reaching the carrying amount of the assets as this would be consistent with paragraph 78 of IAS 36.

15. 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.

Yes.

Do you have any comments?

We agree that unamortised grant should be included when calculating the carrying amount of housing properties for the purposes of assessing impairment.

The responses to the ITC in April 2013 indicated a general consensus that the fair value of stock in a stock swap transaction was EUV-SH. In discussing the method of EUV-SH with the sector's valuers (as set out under Section 14: Impairment of the Consultation Questions) it is noted that EUV-SH 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 EUV-SH 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.

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

Yes.

Do you have any comments?

We agree with the proposed treatment of stock swap transaction on the basis that it is consistent with the requirements of the SORP in relation to grants on properties held at EUV-SH. This conclusion might be challenged on the basis that the balance sheet of a registered social housing provider which reports on a historical cost basis may include some properties on a gross basis (with a separate unamortised grant balances) and others on a net basis. However, we agree that this apparent inconsistency is justified by the different circumstances in which the properties are acquired and that there should be no separate unamortised grant liability in the case of properties acquired at EUV-SH (through a stock swap or otherwise).

17. 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.

Yes.

Do you have any comments?

No comments.