Grant Thornton
An instinct for growth™

An Introduction to FRS102 for Housing

September 2014

Introduction

The Financial Reporting Council (FRC) published Financial Reporting Standard (FRS) 100 'Application of Financial Reporting Requirements' in November 2012. This outlines the standards that make up the new financial reporting framework applicable on a mandatory basis for the majority of UK entities for reporting periods starting on or after 1 January 2015. Housing Associations will be required to apply FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' which was issued in March 2013.

FRS 102 addresses some of the specific reporting issues faced by housing associations and other public benefit entities, including the basis for recognising government grants, business combinations and the recognition of income from various sources. The housing SORP has been updated to reflect the new framework. The final SORP has now been published.

Housing associations will be required to adopt the new financial reporting regime for accounting periods starting on or after 1 January 2015, with the comparative balance sheet and opening comparatives requiring restatement. For many associations this will mean a 1 April 2014 transition date, a 31 March 2015 comparative balance sheet and the first FRS 102 compliant accounts being prepared for 31 March 2016.

However, it is not too soon to start considering how you will address the transition process. From our extensive experience in assisting clients with transition to EU-adopted IFRS, good planning is key to success. Timely actions and the right support will ensure that the process goes as smoothly as possible.

There are also operational matters which may need to be addressed in preparing for transition, such as training requirements for your finance and operational teams, systems changes to ensure relevant information is captured, education of your stakeholders, and the potential need for additional resources.

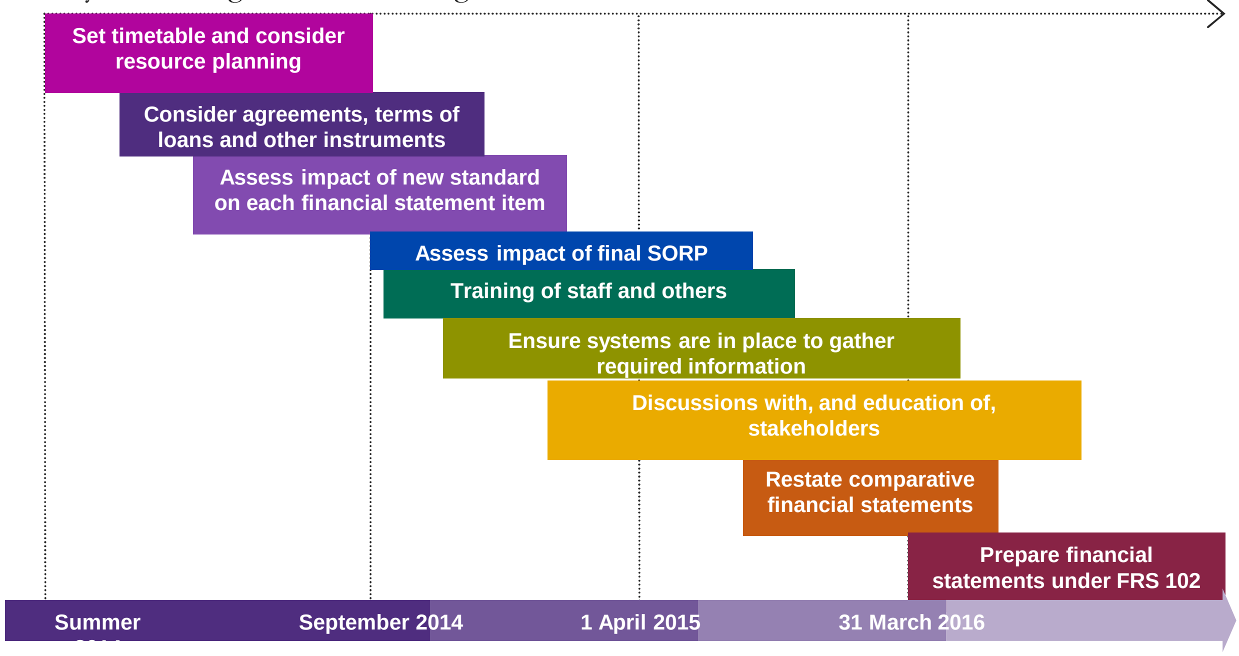
This factsheet provides a summary of the key changes brought about by the proposed FRS 102 compliant SORP (SORP 2014) , our interpretation of the practical effects of implementation, together with suggested actions. Most actions involve conducting a review of accounting policies.

Planning for transition

Transition timeframe

There is no doubt that the transition will require time and has the potential to cause disruption to your finance function. However, this should not just be viewed as a change to your financial statements. The impact on the business as a whole must also be considered carefully. Our experience from assisting our listed clients with the transition to IFRS has shown us that starting to think about the issues early can save time and reduce problems later. With thorough planning and the right support, the process can be made as smooth as possible.

A smooth transition will require careful planning and a plan for a housing association with a March year end might look something like this:



Planning ahead will allow you to address issues such as negotiating bank covenants and having the right amount of resource available

Key areas of impact

We set out below the key areas and issues we have identified as being relevant for the sector. We also provide a high level consideration of actions to include in a transition plan and the potential impact on the financial statements and resources. Unless otherwise stated, the financial statements will need to be restated retrospectively on transition to FRS 102, as if it has always applied. Retrospective adjustments will be reflected in the opening balance sheet reserves.

Impact:	**The assessment for each issue below reflects the potential impact on transition to FRS 102 based on two separate criteria, whilst recognising that some issues may impact different registered providers to a varying extent. Grading of high, medium or low is represented by red, amber and green.**
£:	Potential impact on the financial statements either in terms of the balance sheet or performance statement. High reflects a potentially significant impact on the results and/or position for the association.
Resource:	Potential impact on resources during the transition process. High reflects areas that may be complex and/or resource intensive.

FRS102 issue | *Potential approach*

Housing properties

Property held for social benefit will be classified as property, plant and equipment (PPE), all other housing properties will be shown as investment property. Properties such as student accommodation and commercial units in larger developments will need to be reviewed for the appropriate treatment.

Investment property will generally be held at fair value (not cost) with movements recognised in the I&E. The option to hold other properties (PPE) at cost or valuation is still available and there is also an option to take revalued amounts as deemed cost on transition.

Impact:	£ - High	Resource - High

- Confirm the categories of properties currently held
- Understand the definitions within the SORP 2014
- Review policy of revaluation for PPE
- Calculate impact on balance sheet
- Assess impact on covenants
- Consider presentation and disclosure within the financial statements
- Consider link with grant accounting (see below).

Key areas of impact (continued)

FRS102 issue | *Potential approach*

Social housing grant (SHG)

SHG will be treated as a government grant and can no longer be off-set against the housing property cost.

SORP 2014 requires the performance model to be followed where property is at valuation and the accruals model where property is at cost. Under the accruals model, the grant is amortised over the life of the related structure and components of the asset, but not against land.

SORP 2014 also clarifies the timing of recognising a liability in respect of recycling grants, an area that is still under debate.

Impact:	£ - High	Resource - High

- Review guidance in SORP for method of accounting (and consider whether to keep PPE at cost, use value as deemed cost or move to regular valuation as this will affect treatment)
- Calculate impact on balance sheet
- Assess the impact on covenants.

Intra-group loans

Intra-group loans that are not currently on open market terms are deemed to be financing transactions and will be recognised initially at fair value. Fair value means estimating the expected cash flows and discounting at a market rate. This includes any long-standing 'trading' balances.

For some groups, the impact could be significant if loans are not made on market terms and could result in different values being recognised in each entity within the group.

Impact:	£ - High	Resource - High

- Review intra-group balances to determine treatment.
- Key elements are the rate of interest charged (is it equivalent to the rate that would be available to that entity in the open market) and whether it is repayable on demand.

Key areas of impact (continued)

FRS102 issue

Potential approach

Financial instruments

Under FRS 102, the treatment of financial instruments is different to current UK GAAP. There are now two categories of instrument, basic and other, or non-basic. Non-basic instruments, including all derivatives (eg. forwards, swaps, options) and LOBOs (Lender Option Borrower Option), are reported at fair value which may be a significantly different position from the current amortised cost. Measuring at fair value will impact net assets and is likely to introduce more volatility into the results each year.

FRS 102 allows associations to account for financial instruments under IAS 39 or IFRS 9 (full IFRS). This policy choice may be beneficial to entities with certain non-basic instruments as it could result in reduced volatility.

Volatility in the surplus or deficit may also be reduced, in appropriate circumstances, by applying hedge accounting. Documentation will need to be prepared to demonstrate the hedge has been designated, how the effectiveness will be measured and the effectiveness tests completed to demonstrate that it is effective.

Impact: **£ - High** **Resource - High**

- Undertake a review of the financial instrument agreements to determine classification.
- Consider basis for determining fair value for any non-basic instruments (eg. open market value, discounted cash flows etc).
- Consider whether applying full IFRS could provide a better result in terms of volatility where there are non-basic instruments.
- Note that hedge accounting is available in certain circumstances and will need separate consideration. If hedge accounting is applicable, we recommend seeking advice early on in the transition process.

Key areas of impact (continued)

FRS102 issue	*Potential approach*
Retirement benefits Multi-employer schemes, such as SHPS, can be accounted for as defined contribution schemes if the share of assets and liabilities for each entity cannot be determined. There will, however, be a need to recognise any contractual obligations with the pension scheme. This will include the agreements to pay additional contributions to fund the deficit. This contractual obligation will need to be included at its net present value.	**Impact:** **£ - High** **Resource - Medium** • Consider what agreements are in place with the pension fund. • Consider impact of additional liability on the net asset position. • Assess overall impact on net incoming resources, including the unwinding of the discount and any year on year movements in the provision. • Consider information from the pension scheme as the next review date approaches and factor any expected increases in obligation into the relevant forecasts. • Consider the impact of the additional obligation on bank covenants.
Group defined benefit schemes Under current UK GAAP the deficit or surplus on a group defined benefit scheme might only be shown in the consolidated financial statements if the available exemption is taken on the basis that it is not possible to split the share of assets and liabilities between the group companies. Under FRS 102, such a deficit or surplus must be recognised in the individual accounts of at least one group entity. By default this will be the entity that is legally responsible for the plan (this is often the parent). This could have a significant impact on that entity's accounts. The default treatment may be avoided where a group has a stated policy or contractual agreement for charging the net defined benefit cost as calculated under FRS 102 to one or more individual group entities.	**Impact:** **£ - High** **Resource - Medium** • Consider whether the requirement to apply defined benefit accounting in an individual entity's financial statements may apply. • Consider introducing a stated policy or contractual agreement to allocate the liability amongst group entities. • When introducing such a policy or agreement, take care over the wording and its impact on the allocation of the liability. • If applicable, this issue should be considered early in the transition process as any stated policy or contractual agreement cannot be retrospectively applied.

Key areas of impact (continued)

FRS102 issue

Potential approach

Impairment

The exposure draft of SORP 2014 introduced a number of changes to accounting for impairment including the removal of planned internal subsidy.

Following a second consultation, SORP 2014 requires a stepped process to calculating impairment. If there is an indication of impairment, the carrying amount of the asset should be compared to the recoverable amount. If the recoverable amount is lower than the carrying value, the association will need to record an impairment.

- Indications of impairment include changes in regulation or market factors, but does not automatically include the fact that the fair value ie EUV-SH of the asset may lower than the cost.
- Associations must determine the appropriate level of assessment for the impairment, based on the cash generating units
- The recoverable amount can be calculated based on:
  - the fair value, usually EUV-SH
  - the value in use, being the discounted cash flows, or
  - value in use – service potential, recognising that the asset may not be held primarily to generate cash but is also to provide a social benefit. The basis for measurement will usually be depreciated replacement cost although other methods may be acceptable.

Impact: **£ - Medium** **Resource - Medium**

- Review carrying value of assets at the opening balance sheet date
- Consider if there are indicators of impairment
- Review the appropriate levels of assessment for impairment based on the cash generating unit, in particular considering mixed tenure developments
- Where necessary, calculate the impairment provision based on the guidance in the SORP 2014
- Assess impact on covenants.

Key areas of impact (continued)

FRS102 issue | *Potential approach*

Financial statement presentation

Based on SORP 2014, financial statements consist of the following:

a. Statement of comprehensive income (SCI)
b. Balance sheet
c. Statement of cash flows
d. Notes, including accounting policies.

Key changes include:

- designated reserves are no longer allowed in the financial statements
- Social Housing Grant is no longer off-set against the cost of housing properties, but held as deferred income within creditors
- reduced number of headings on the face of the cash flow statement
- cash flow statement to be reconciled to the total of 'cash and cash equivalents'
- SORP 2014 requires a strategic report for all entities with over 5,000 homes.

Impact: **£ - Medium** **Resource - Medium**

- Review the mapping of the nominal ledger to ensure the trial balance reflects changes to the presentation in the financial statements.
- Review accounting policies to ensure they are FRS 102 and SORP 2014 compliant.
- Prepare skeleton accounts in advance of the first year end in sufficient time to allow input from the Board and in order to obtain any information that is not readily available.
- Consider impact of changes on bank covenants, if applicable.
- Communicate changes to stakeholders.

Creditors

Additional liabilities may be required for short term employee benefits such as holiday pay. For example, an accrual may be required for those holidays not taken at the year end – where the year end is not in line with the holiday year this may require detailed calculations.

Impact: **£ - Medium** **Resource - Medium**

- Review systems to capture information on holidays carried forward
- Consider the alignment of the holiday and financial year ends, bearing in mind any impact on HR issues
- A calculation for the opening balance sheet at the date of transition will be required.

Key areas of impact (continued)

FRS102 issue

Potential approach

Leased assets

Under FRS 102, there is no rebuttable presumption that where the present value of the minimum lease payments is 90% or more of the fair value of the asset, then the lease is a finance lease. Therefore greater judgement may be required to distinguish between a finance and operating lease.

Lease incentives are released over the lease term as opposed to the period up to the first rent review, although transition relief is available.

Impact: **£ - Medium** **Resource - Medium**

- Review lease arrangements to determine treatment.
- Calculate delayed recognition of lease incentives for any leases contracted after the transition date (eg. 1 April 2014).

Taxation

For entities that are subject to tax, the changes to the accounting treatments may have a knock on effect on the tax treatment. For example valuation of intra-group loans will result in imputed interest charges being recognised in the results, and which may not be allowable for corporation tax purposes. The changes may also impact the level of profits available to be gifted to the parent entity.

Impact: **£ - Medium** **Resource - Medium**

- Assess potential tax implications of changes to the accounting policies.

Key areas of impact (continued)

FRS102 issue	*Potential approach*
Debtors No significant impact on transition although any extended credit arrangements (eg. payment plans) for rental arrears need to be discounted to the net present value using an appropriate market rate of interest.	**Impact:** £ - Low · Resource - High • Consider whether any arrangements may be material • If so, determine the market rate of interest to be applied to the net present value calculation.
Improvements to properties (under stock transfer agreements) The related assets and liabilities under these agreement are required to be shown gross on the balance sheet as amounts cannot be offset under FRS 102.	**Impact:** £ - Medium · Resource - Medium • Review current agreements in place • Determine measurement basis for the asset and the liability at cost or fair value.
Defined benefit schemes The net finance charge in the net surplus/deficit includes the interest income on the plan assets and the interest expense on the plan liabilities. Under FRS 102, the interest income will be calculated using the discount rate applied to the pension liabilities rather than the expected return on the assets. This is likely to result in an increase in the net finance charge. There is no longer a requirement to have an independent actuarial valuation each year.	**Impact:** £ - Medium · Resource - Low • Consider the impact on the surplus/deficit. • Consider impact on covenants.

Key areas of impact (continued)

FRS102 issue	*Potential approach*
Related party and remuneration disclosures Related parties – the definition of a related party includes key management personnel, and therefore, additional disclosure is required for the total remuneration for those responsible for the management of the association. Disclosures are also required for tenant board members, including the amount of rent charged and any balances in arrears at the year end.	**Impact:** £ - Low; Resource - Low • Review information held about related party transactions for missing information • Consider impact of additional disclosures relating to remuneration on stakeholders, particularly tenant board members.
Investments Investments in subsidiaries are measured at cost or fair value. Fair value movements can go through either net incoming resources or other recognised gains or losses, rather than through other recognised gains or losses under current UK GAAP. Investments in joint ventures and associates are measured at cost or fair value, as above, in the individual accounts and using the equity method in the group accounts.	**Impact:** £ - Low; Resource - Low • Determine accounting treatment for each investment.
Concessionary loans FRS 102 allows a policy choice for certain loan arrangements made to or from a public benefit entity or group. These have to be made to further the public benefit and be at a below market rate. If the conditions are met, the association can elect to follow the accounting for a financial instrument, or hold at amortised cost as per current UK GAAP.	**Impact:** £ - Low; Resource - Low • Determine if any loan arrangements meet the criteria of a public benefit entity concessionary loan eg. Homebuy • Select the appropriate policy for accounting.

How Grant Thornton Can Help

Grant Thornton has depth and strength across the Firm so your transition review will be performed by a relationship-led housing specialist engagement team, supported by a dedicated, project based housing accounting and financial reporting technical team that specialises in SORP 2014 conversions and training.

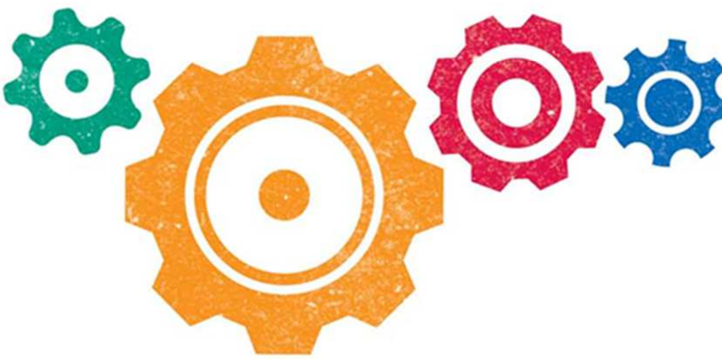
- We will work closely with you to ensure that your SORP 2014 accounting policies are understood and applied appropriately in the context of your organisation and that the implications of these policies are understood (for example the impact that new sources of income will have on reported financial performance and how best to report this both internally and externally).

- We will provide you with practical interpretations of existing and new accounting standards, to ensure that you are fully SORP 2014 compliant, as well as adopting accounting policies and practices that are relevant to your association.

- We will provide you and your finance teams with on-going support throughout this process and after completion, so you always have someone to support the practical implementation of SORP 2014 after the initial conversion period. We are ideally situated to provide all of the support you require.

- We are at the forefront of development in the sector specific guidance. Our FRS 102 specialists were seconded to the Accounting Standards Board so Grant Thornton directly influenced the formation of the new UK reporting framework. We have team members on both the SORP working party and the ICAEW Housing technical sub committee.

Further detail on the different levels of service we can provide can be found on the following pages.



Full, 'hands-on' assistance

Providing full, 'hands-on' assistance would include the following:

- spend time meeting relevant, different teams/individuals to understand your organisation
- hold an impact assessment workshop with you to understand the key areas of difference arising from adoption of FRS 102 and SORP 2014
- formal, documented review of accounting policies noting any potential differences under SORP 2014
- formal, documented review of your 2013 transactions, balances and financial statements identifying potential SORP 2014 differences
- through discussion with you, understand future transactions (particularly those post your 2014 transition date – assuming a 31 March year end) which may be accounted for differently under SORP 2014 and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements
- assessment of actual transactions in 2014, 2015 and 2016 considering the impact of SORP 2014
- papers would then be prepared with calculations and supporting documentation covering the identified areas for the years 2014, 2015 and 2016
- a financial statements template (including all the relevant notes) would be prepared in accordance with SORP 2014 which would then be populated
- review of your financial statements, prepared under SORP 2014, by our housing technical team.

Acting as reviewer

Acting in a review capacity we would propose to assist as follows:

- spend time meeting relevant, different teams/individuals to understand your organisation
- hold an impact assessment work shop with you to understand the key areas of impact from SORP 2014
- through discussion with you, understand future transactions (particularly those post your 2014 transition date) which may be accounted for differently under SORP 2014 and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements or treatment of future business combinations.
- assess your review of accounting policies under SORP 2014 noting any potential omissions
- assess your review of the 2014 (transition balance sheet) 2015 and 2016 transactions, balances and financial statements identifying potential SORP 2014 differences including a review of your work papers
- provide a financial statements template (including all the relevant notes) in accordance with SORP 2014 which would then be populated by your finance team
- review and comment on your financial statements.

Impact assessment

Our impact assessment involves the following:

- spending time meeting relevant, different teams/individuals to understand your organisation
- through discussion with you, understanding future transactions (particularly those post your 2014 transition date) which may be accounted for differently under SORP 2014 and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements or treatment of future business combinations
- preparing an impact assessment detailing key differences between existing SORP and SORP 2014 – that assessment will also highlight what needs to be done and by when.

Using our sector experience to add value

1

Sector specialists

Through our sector focused approach we have established a strong reputation as social housing specialists with the result that we now provide assurance and audit services to over 100 housing organisations (with more than 130 clients in the sector in total).

2

Not for profit technical

Our substantial client base has enabled us to develop a strong national not for profit technical function to support our teams and clients in meeting the changes to accounting standards, legislation and taxation.

3

Model Accounts

Once the SORP is finalised we will continue to provide our model financial statements with a set under current and new UK GAAP.

4

Understanding developments

We stay up to date on the latest changes. We are represented by Jenny Brown on the Institute of Chartered Accountants in England and Wales (ICAEW) housing sub committee and by Kyla Bellingall on the SORP working party.

5

Access to a specialist team

Grant Thornton's established and dedicated, project based Financial Reporting Advisory Group (FRAG) specialises in IFRS and FRS 102 conversions and IFRS and FRS 102 training. Our specialists are qualified in IFRS and UK GAAP and now FRS 102, including for housing entities. Members of our FRAG team hold the advanced diploma in IFRS and are experienced IFRS practitioners.
We have worked with various AIM listed and public sector bodies as they transitioned to IFRS based standards and understand the key issues around the management of such a project.

6

Wide technical expertise

Our National Assurance Services (NAS) team also responds to the latest technical developments and issues in the profession by providing commentary on the firm's views. They produce thought leadership material for emerging themes on topics such as auditing, financial reporting and ethics.

Contacts

Louise Kelly
Partner, Audit
T +44 (0)28 9587 1100 E
louise.kelly@ie.gt.com

Michael Barnett
Director, Audit
T +44 (0)28 9587 1127
E michael.barnett@ie.gt.com

Grant Thornton (NI) LLP
10th Floor
Clarence West Building 2 Clarence Street West Belfast
BT2 7GP

@GrantThorntonNI

Offices also in Dublin, Cork, Galway, Kildare, Limerick

and Longford.

Grant Thornton
An instinct for growth™