Accounting discussion document

Accounting considerations for housing associations for the financial year to 31 March 2020

Summary

The following document discusses a series of accounting considerations for housing associations at 31 March 2020 year ends centring on the following two areas:

1) The impact of coronavirus on impairment reviews of social housing

2) Pensions accounting – McCloud and GMP Equalisation for 31 March 2020 year ends

These two areas are being discussed in this document because of their specificity to housing associations. There may be other areas that have implications for housing associations when preparing their year-end accounts and these should also be considered.

The NHF would like to thank Julia Poulter from Crowe UK (technical adviser to the Housing SORP Working Party) and Katy Taylor from Isio (the NHF's pensions adviser) for the following updates.

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NATIONAL HOUSING FEDERATION

1) The impact of coronavirus on impairment reviews of social housing property

The coronavirus global pandemic is having profound financial and operational implications for all businesses including housing associations. One area that housing associations should be considering at the reporting date is whether there is any indicator of impairment of assets.

The assessment of indicators of impairment is at the reporting date. There is a general consensus to treat the coronavirus outbreak as a non-adjusting event for 31 December 2019 year ends so housing associations with a December year end would not be considering current events as an indicator of impairment (although they should be considering additional disclosures). For March 2020 year ends, housing associations will need to consider the indications and impact.

Social housing properties

FRS 102 and the Housing SORP provide indicators that should be considered but it is worth highlighting that the list is not exhaustive. Whilst the pandemic is not a defined indication outright, there are indications provided in paragraph 14.6 of the SORP that should be considered, discussed below:

- **A change in government policy, regulation or legislation which has a material detrimental impact on the development programme or scheme.**

The UK government has imposed restrictions that are having a material impact on the nation's ability to work. The Secretary of State for Housing, Communities and Local Government Robert Jenrick has called on housing and construction workers to stay at home if possible during the coronavirus lockdown, but has said sites can remain open. Funding could be impacted, delays could add costs and, in some cases, render a development programme unviable – therefore, ongoing developments should be reviewed for impairment.

- **A change in demand for a property that is considered irreversible. For example, a material increase in the level of voids exceeding those originally forecast and which is not anticipated to reverse in future periods without material additional expenditure being incurred.**

Whilst housing associations may experience a change in demand during this time and voids may increase where void repair work cannot be completed due to restrictions imposed on the workforce, it is unlikely that this is considered irreversible. Therefore, housing associations are unlikely to conclude that this is an indicator of impairment.

- **A material reduction in the market value of properties in those circumstances where assets are intended or expected to be sold or where the occupant has the right to purchase under shared ownership arrangements.**

Savills have highlighted that the effect of coronavirus on the housing market is likely to come from three areas:

1. The impact it has on sentiment, making all but the most committed buyers more cautious in the short term, at least until global stock markets stabilise.

2. The practical impact it has on buyers' and sellers' ability to transact, as it limits people's ability to go about their normal business.

3. Its impact on the economy and the traditional drivers of affordability.

Therefore housing associations should consider this indication of impairment for shared ownership properties and properties currently held for sale.

In accordance with paragraph 14.10 of the SORP, where an indicator of impairment exists, a housing association must perform an impairment assessment as follows:

(a) Determine the level at which an impairment is to be assessed (i.e. the asset or cash-generating unit).
(b) Estimate the recoverable amount of the asset or cash-generating unit.
(c) Calculate the carrying amount of the asset or cash-generating unit.
(d) Compare the carrying amount to the recoverable amount to determine if an impairment loss has occurred.

An impairment loss occurs when the carrying amount of an asset or cash generating unit exceeds its recoverable amount. In accordance with paragraph 14.11 of the SORP, this impairment loss must be charged to the Statement of Comprehensive Income (OCI) as expenditure and disclosed as a separate line within operating expenditure where it is considered to be material.

Inventories (stock)

As for shared ownership properties, housing associations must assess at the reporting date whether any inventories are impaired by comparing the carrying amount of each item of inventory (stock) with its selling price less costs to complete and sell. This is particularly relevant to housing associations holding properties developed for outright sale which are classified as inventory (stock).

In accordance with paragraph 14.39 of the SORP, if an item of inventory (stock) is impaired, a housing association must reduce the carrying amount of the inventory (stock) to its selling price less costs to complete and sell and that reduction is an impairment loss which is recognised immediately in the income and expenditure.

Market value assessments

When assessing the selling price of stock, the fair value of Investment Properties and other properties where organisations have a policy of revaluation, housing associations will need to consider the uncertainty of valuation estimates. Realistically it is going to be difficult to value property by reference to market value at 31 March 2020. In a notification to members RICS (the Royal Institution of Chartered Surveyors) stated “Inspecting property may be difficult and access to evidential data such as comparables, less freely available. RICS Regulated Members and firms may therefore be considering whether a material uncertainty declaration is now appropriate using the Red Book Process”.

Housing associations are required to disclosure the key assumptions applied in determining the value of these properties to comply with financial reporting requirements:

- Investment properties – Paragraph 16.10(a) of FRS 102.
- Properties held using the revaluation model – Paragraph 17.32A(c) of FRS 102.
- When measuring the recoverable amount for impairment reviews – Paragraph 14.44(d) of the housing SORP.

A sensitivity disclosure that includes the assumptions applied may be necessary where the valuation has a high degree of estimation uncertainty. Auditors may wish to draw users’ attention to this by way of an emphasis of matter paragraph or in the response to key audit matters within the auditor’s report.

Auditors will need to consider the objectives and requirements of International Standards on Auditing (UK) 540 (ISA (UK) 540) Auditing Accounting Estimates and Related Disclosures. In certain circumstances, auditors may consider a modification of their opinion appropriate in accordance with the International Standard on Auditing (UK) 705 (ISA (UK) 705). This will depend on the degree of estimation uncertainty highlighted by the valuer and the materiality of judgements made. It is likely that a modification would be on the basis of “Inability to obtain sufficient appropriate audit evidence” (this is often referred to as a limitation of scope).

Where a potential material change to the valuation of properties may affect a housing association’s asset cover banking covenant they should seek to obtain a covenant waiver at the reporting date. Where a breach has not been remedied by the reporting date housing associations should follow the reporting and disclosure requirements of FRS 102 (11.47) and may need to reclassify debt as due within one year.

2) Pensions accounting – McCloud and GMP Equalisation for 31 March 2020 year ends

The NHF has been working with housing association auditors and finance directors (including members of the Housing SORP Working Party) and Isio, our pensions policy advisors, in order to assess the issues for housing associations on the valuation of assets and liabilities, the McCloud judgment and Guaranteed Minimum Pension Equalisation (GMPE) allowance for organisations accounting for Local Government Pension Scheme (LGPS) pension liabilities as at 31 March 2020. There have been changes since the year end 31 March 2019 which will need to be considered and dealt with.

We are aware that, this year, auditors will have had more time to consider the treatment (within materiality limits) for McCloud and GMPE than was the case in 2019. Auditors have been in touch with the LGPS scheme actuaries to set out expectations on measurement and treatment and we have set out below a summary of the key points we expect to be included in this guidance. LGPS actuaries should be taking this into account when advising their LGPS fund clients. We hope that these key points will help organisations understand the right approach. It should also help you know what to expect from your LGPS fund(s).

Making appropriate allowance for benefit promises as a result of the McCloud judgment and GMPE remains an area of complexity and may differ from the approach taken in 2019. Having an early view on how you (and your LGPS fund) will calculate the allowance for your organisation and where the impact will be recognised, as well as agreement with your auditor, is important. Taking a lead as an organisation rather than waiting for your fund to propose an approach, is likely to make the process more efficient.

With that in mind, here are three key questions for an organisation to ask itself early on in its year end process:

Key questions for your organisation to ask now

1. **What approach did our organisation take last year?**

   This will include:

   - benefits valued (for example, this might not have included early leaver benefits)
   - population considered (for example, this might have excluded deferred pensioners and pensioners)
   - calculation methodology, including the level of employer specific assumptions
   - materiality

2. **Is my LGPS fund actuary going to produce a compliant balance sheet allowance this year?**

   This will be an employer specific estimate based on auditor guidance set out below.

3. **Where should a difference between 2019 and 2020 allowance be recognised – I&E or OCI?**

   Broadly speaking, we would expect any additional allowance to be recognised through I&E, unless limited to a change in assumptions. Again, see the guidance set out below.

Coronavirus impact: Given the ongoing impact of coronavirus on businesses and pension schemes, it may be that your LGPS fund takes longer to produce initial disclosures than normal, either because of difficulty valuing all asset categories appropriately or because of the pressure on administration teams at the

moment. You may want to confirm with your fund the timescales for production of draft disclosures and consult on assumptions prior to receiving these.

If you would like further information or support on these or other issues, please contact us or Isio (katy.taylor@isio.com).

Auditor guidance to LGPS Actuaries on McCloud and GMP Equalisation – key points

This is a list of key points we expect to be included in auditors' guidance notes to LGPS fund actuaries, based on our understanding as at 31 March 2020.

McCloud

- The McCloud judgement in December 2018 resulted in a change in the underlying obligation and potential cost of future benefit accrual. This should have been accounted for during that period (e.g. for year to 31 March 2019) and where material, recorded as a plan amendment (past service cost) in the I&E.

- Given ongoing uncertainties during 2019, some employers did not make allowance for the changes at the required time.

- In July 2019, the government conceded that the ruling does apply and therefore we would now expect all employers to reflect this.

- This should be an employer-specific adjustment, either based on detailed modelling or an appropriate adjustment to a central estimate (e.g. from the Government Actuary's Department).

- Where no allowance was made in 2019, the accounting will depend on the prior year treatment and materiality of the change. This should be discussed between the employer and the auditor. In some cases, if the change is material and treatment meets the definition of a prior period error, it should be corrected by restating the comparative amounts.

- Even where the actuary's 2019 actuarial valuation (for England or Wales LGPSs) does not include an allowance for McCloud, as this is a legal obligation, it should be included in the IAS 19 or FRS 102 valuation this year.

- We would expect the McCloud estimate to be based on the latest available information. If allowance was made in the previous year, a re-measurement of the estimate would be recognised in the OCI, unless it represents a change in the underlying obligation (e.g. change in employees, deferred members or pensioner members caught by remedy) from that accounted for in the previous period.

- It should be clear what the basis is for calculating the impact, in particular:

  - What is the date of the calculation? The date of judgment was in December 2018, meaning that this should theoretically be "as at" that date. Any changes to assumption methodology (e.g. salary increase assumptions) should be considered when determining the cost.

  - Which members are included or excluded from the allowance (e.g. is there any impact for current deferred or retired members). To the extent that members have been excluded on the grounds of materiality, they should be able to provide evidence that this approach is reasonable.

- It should be clear what allowance has been made both in FRS 102's Defined Benefit Obligation and in the service cost for accrual over the year.

GMP Equalisation / Indexation

- LGPS funds are expected to equalise GMPs. It has been widely viewed that they can do this via extending full CPI indexation across all GMP benefits.

- Different actuaries have historically made different allowances for indexation – e.g. to 2018, to 2021, or full indexation.

- Changes to indexation would generally be recognised in the I&E, as they represent a change in the underlying obligation rather than a change in assumptions.

- The accounting considerations for GMPE are the same as for McCloud.

- It may be that there are additional GMPE considerations for some members, which may need separate consideration in future once further clarity is obtained.