

Housing SORP Making Body response to FRED 82

This is the Housing Statement of Recommended Practice (SORP) Making Body's response to the Financial Reporting Council's (FRC) consultation on Financial Reporting Standard 102 (FRS 102), Financial Reporting Standard Exposure Draft (FRED) 82.

Question 1: Disclosure

Do you have any comments on the proposed overall level of disclosure required by FRS 102? Do you believe that users of financial statements prepared under FRS 102 will generally be able to obtain the information they seek? If not, why not?

The SMB agrees in principle with the benefit of narrative disclosures to ensure the qualitative characteristics of relevance and faithful representation and that disclosures aid the users of the financial statements to understand the presented financial information. However, there are certain areas where the SMB feel the disclosure requirements as currently drafted are overly onerous on Registered Providers of Social Housing (hereafter referred to as "RPs"). This is in the context that RPs have additional disclosure requirements imposed by the Regulators of Social Housing in the four countries of the United Kingdom. For example, in England the Regulator of Social Housing ("RSH") requires additional reporting disclosures in the annual report and accounts through:

- (a) "The Accounting Direction for private registered providers of social housing"; and
- (b) The Regulatory Standards

In particular the SMB believe that the following disclosure requirements of Section 20 Leases (whilst similar to current FRS102 requirements) will require excessive disclosures that do not add any enhancements to the users of the financial statements and the SMB welcomes the opportunity for the Housing SORP to revisit this area and consider reduced/simplified disclosures that are appropriate for the sector and users of the accounts and allow better comparability between RPs.

Key area for consideration being:

20.121 A lessor shall disclose a general description of its significant leasing arrangements, including, for example, information about variable lease payments, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements. A lessor shall, if necessary to enable users to understand their leasing arrangements, disclose additional qualitative and quantitative information about these arrangements.

20.126 A lessor shall disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

The aim of RPs generally is to provide housing to rent at below market level rents, or to buy through schemes such as shared ownership, that is made available to those whose needs are not served by the commercial housing market. However, in order to finance social housing RPs may also develop/acquire property to rent at market values.

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As such a RPs may have the following types of leasing arrangements within their portfolio as a lessor:

- Social rents - set using a government formula.
- Affordable rents - which permits rents to be set at up to 80% of market rent (inclusive of service charges).
- Intermediate rents - provided for rent at a level above social and affordable rents, but below market levels.
- Market rents - comparable to privately rented properties in the location.
- Shared ownership - scheme that allows people to buy a part share of home (first tranche typically 25%), if they are unable to buy whole property. RP retains the remainder and charge rent on this portion. Shared owners can increase their stake in the home, through a process known as staircasing.

Tenancies may be:

- A starter tenancy - New housing association tenants may be offered a starter tenancy. These usually last 12 months and are like a 'trial' period.
- An assured shorthold tenancy – either fixed term or rolling, the RP will include the period in the tenancy agreement and the renewal criteria.
- Lifetime tenancy - meaning you can normally live in your property for the rest of your life and in certain circumstances the lifetime of dependants.

Additionally, some tenancies may convey the right to buy or the right to shared ownership.

The complexity of the lessor portfolio of RPs will therefore make for extremely lengthy disclosures if they are to comply with the disclosure requirements of Section 20. The Accounting Direction also imposes detailed disclosure requirements to show segmental analysis of income between social housing and non-social housing and rent receivable split between different categories of housing (such as general needs and supported housing). The Accounting Direction also requires the annual charge in respect of leases to be disclosed within a note "Particulars of turnover and operating expenditure from social housing lettings", as well as details in respect of "capital funding and capital commitments" and "other commitments".

Question 2: Concepts and pervasive principles

The proposed revised Section 2 Concepts and Pervasive Principles of FRS 102 and FRS 105 would broadly align with the IASB's 2018 Conceptual Framework for Financial Reporting. The IASB's Exposure Draft Third edition of the IFRS for SMEs Accounting Standard (IASB/ED/2022/1) contains similar proposals. The FRC considers it appropriate that FRS 102 and FRS 105 should be based on the same concepts and pervasive principles as IFRS Accounting Standards including the IFRS for SMEs Accounting Standard, given the FRC's aim of developing financial reporting standards that have consistency with global accounting standards. The FRC has made different decisions from the IASB in some respects in developing proposals to align FRS 102 and FRS 105 with the 2018 Conceptual Framework in a proportionate manner.

Do you agree with the proposal to align FRS 102 and FRS 105 with the 2018 Conceptual Framework? If not, why not?

This FRED, and IASB/ED/2022/1, propose to continue using the extant definition of an asset for the purposes of Section 18 Intangible Assets other than Goodwill and the

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extant definition of a liability for the purposes of Section 21 Provisions and Contingencies of FRS 102. This is consistent with the approach taken in IAS 38 Intangible Assets and IAS 37 Provisions, Contingent Liabilities and Contingent Assets which use the definitions of an asset and a liability from the IASB's 1989 Framework for the Preparation and Presentation of Financial Statements.

Do you agree with this approach? If not, why not?

Do you have any other comments on the proposed revised Section 2?

The SMB agree with the proposal to align FRS102 with the 2018 Conceptual Framework. However, we have noted some areas where we would appreciate further consideration by the FRC.

Asset definition

We welcome the removal of the direct linkage of benefits to cashflows or equivalents that exist within the current wording of Section 2 "The future economic benefit of an asset is its potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. Those cash flows may come from using the asset or from disposing of it."

It was noted that the FRC made this comment in the basis of conclusion "Stakeholders sought additional guidance regarding the capitalisation of asset enhancements intended to provide climate or other ESG benefits. The amendments proposed to Section 2 introduce a new definition of an asset. This sets out examples of rights that have the potential to produce economic benefits, including a right to use a physical object. The FRC does not propose to make amendments to Section 17 at this time in relation to this issue."

The SMB were disappointed that proposals do not provide further guidance on capitalisation of asset enhancements intended to provide climate or other ESG benefits as this had been raised by stakeholder engagement groups. The SMB consider this an important sector matter due to the Net Carbon Zero targets imposed on Housing Providers. Data indicates that the sector issued £3bn of ESG linked bonds in 2021¹.

We would welcome further guidance on this significant topical matter or we welcome the opportunity to include this within the Housing SORP to ensure that there is consistency and comparability in accounting and reporting in an area that is of significant interest to stakeholders.

The SMB are also looking at how these changes to Section 2 (linked with Section 17 and Section 21) impact on the sector's ongoing discussions and the accounting and reporting implications in respect of building/fire safety work such as capitalisation, provisions and impairment and welcome the opportunity to provide further guidance within the Housing SORP to ensure that there is consistency and comparability in accounting and reporting in an area that is of significant interest to stakeholders.

The SMB would like further clarification on whether it is possible to recognise a provision (liability) for future capital expenditure to rectify a breach of legislation, whereby that provision creates a Property, plant and equipment asset. It has previously been, informally, conveyed by the FRC that this is permissible. However, we note the revised definition of an asset to be "a

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present economic resource controlled by the entity as a result of past events” and that “An economic resource is a right that has the potential to produce economic benefits.”

“Control links an economic resource to an entity”. The SMB would question whether it is possible to “control” an economic resource where a PPE asset hasn’t physically or contractually been acquired and no right transferred.

Liability definition

The SMB believes that preparers of accounts may find the interaction between Section 2 and Section 21 Provisions and Contingencies confusing due to the use of two different definitions. The SMB further questions the need for Section 21 following the changes made to Section 2 definitions of an asset and a liability.

We note the following addition to section 21

21.4 A “This section uses the term ‘provision’ in a way that differs in some respects from the definition of a liability in paragraph 2.42 and Appendix I Glossary. For the purposes of this section, a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.”

We note the glossary definition of a provision is unchanged, being “A liability of **uncertain timing or amount.**” In relation to amount we find this confusing considering the proposed definition of a liability has now removed the requirement which exists in the current wording of Section 2 “the settlement amount can be measured reliably.” In relation to uncertain timing this is also confusing when considered in conjunction with the following proposed wording in Section 2:

2.45 “To satisfy the criterion in paragraph 2.43(b), the obligation must have the potential to require the entity to transfer an economic resource to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer an economic resource – the transfer may, for example, be required only if a specified uncertain future event occurs. It is only necessary that the obligation already exists and that, in at least one circumstance, it would require the entity to transfer an economic resource.”

We would therefore question when it would be appropriate to use the term “Provision” based on the current definition and interaction with Section 2 and seek further clarification in this area.

Question 3: Fair value

The proposed Section 2A Fair Value Measurement of FRS 102 would align the definition of fair value, and the guidance on fair value measurement, with that in IFRS 13 Fair Value Measurement. Do you agree with this proposal? If not, why not?

Do you agree with the proposed consequential amendment to Section 26 Share-based Payment of FRS 102 to retain the extant definition of fair value for the purposes of that section? If not, why not?

We agree with the proposal to align the definition of fair value and the guidance on fair valuation measurement with that in IFRS13 Fair Value Measurement.

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Due to the nature of the majority of RPs being constituted as Non-Profits, Section 26 Share-based Payments is not an area of financial reporting that is particularly significant. However, similar to our response to Question 2 it may make it confusing for preparers and users of financial statements to have more than 1 definition of a term within FRS102.

Question 4: Expected credit loss model

The FRC intends to defer its conclusion as to whether to align FRS 102 with the expected credit loss model of financial asset impairment from IFRS 9 Financial Instruments pending the issue of the IASB's third edition of the IFRS for SMEs Accounting Standard. Any proposals to align with the expected credit loss model will therefore be presented in a later FRED. Do you agree with this approach? If not, why not?

In IASB/ED/2022/1 the IASB proposes to retain the incurred loss model for trade receivables and contract assets, and introduce an expected credit loss model for other financial assets measured at amortised cost. The FRC's preliminary view is that, in the context of FRS 102, it may be appropriate to require certain entities to apply an expected credit loss model to their financial assets measured at amortised cost, but allow other entities to retain the incurred loss model. Do you agree with this view? If not, why not?

Based on stakeholder feedback received to date, the FRC does not intend to use the existing definition of a financial institution to define the scope of which entities should apply an expected credit loss model. The FRC's preliminary view is that it may be appropriate to define the scope based on an entity's activities (such as entering into regulated or unregulated credit agreements as lender, or finance leases as lessor), or on whether the entity meets the definition of a public interest entity. Do you have any comments on which entities should be required to apply an expected credit loss model?

The SMB agree with the FRC's proposal to defer any conclusion to align FRS102 with the expected credit loss model from IFRS9.

The SMB was concerned however with the FRC's possible proposal to set the requirement to follow an ECL model based on whether an entity is a Public Interest Entities (PIE). There is a growing number of PIEs in the RP sector on the basis of holding listed debt. We believe implementation of ECL model for PIEs will create inconsistency in the RP sector. We do not consider appropriate to have this sector disparity, as the underlying basis and nature of the asset and the wider macro-economic environment does not change simply because an entity is a PIE.

Question 5: Other financial instruments issues

When it has reached its conclusion as to whether to align FRS 102 with the expected credit loss model, the FRC intends to remove the option in paragraphs 11.2(b) and 12.2(b) of FRS 102 to follow the recognition and measurement requirements of IAS 39 Financial Instruments: Recognition and Measurement. This intention was communicated in paragraph B11.5 of the Basis of Conclusions to FRS 102 following the Triennial Review 2017. In preparation for the eventual removal of the IAS 39 option, the FRC proposes to prevent an entity from newly adopting this accounting policy. Do you agree with this proposal? If not, why not? Temporary amendments were made to FRS 102 in December 2019 and December 2020 in relation to interest rate benchmark reform (IBOR reform). The FRC intends to consider, alongside the future consideration of the expected

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credit loss model, whether these temporary amendments have now served their purpose and could be removed. Do you support the deletion of these temporary amendments? If so, when do you think they should be deleted? If not, why not?

We agree with the proposal.

Question 6: Leases

FRED 82 proposes to revise the lease accounting requirements in FRS 102 to reflect the on-balance sheet model from IFRS 16 Leases, with largely-optional simplifications aimed at ensuring the lease accounting requirements in FRS 102 remain cost-effective to apply. An entity electing not to take these proposed simplifications will follow requirements closely aligned to those of IFRS 16, which is expected to promote efficiency within groups.

Do you agree with the proposals to revise Section 20 of FRS 102 to reflect the on-balance sheet lease accounting model from IFRS 16, with simplifications? If not, why not?

Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

Whilst we recognise the significant amount of work that will be necessary from the RP sector to implement the proposed changes and the resulting impact on loan covenants, the SMB agrees with the proposal to revise Section 20 of FRS102 to reflect the on-balance sheet lease accounting model from IFRS 16 and recognises that this will improve comparability between RPs that lease and those that borrow to buy.

As context the 2022 global accounts which collate financial statements of RPs with over 1,000 units reported the total aggregated amount of future obligations under operating leases disclosed in the financial statements to be £1.9bn. It was noted that there are three providers with operating lease commitments in excess of £200m, together accounting for 54% of the total. One provider operating a lease-based business model accounts for 31% (£0.6bn) of the total operating lease obligations. These commitments are currently off-balance sheet compared to the £89.2bn of debt on-balance sheet.

We agree with the proposal that leases should be recognised on the balance sheet, and therefore agree with the proposed revisions to Section 20 of FRS 102 although have highlighted areas where further clarification or guidance would be welcomed for the Social Housing sector.

We welcome the proposed simplifications. We have set out below the areas of focus for the SMB and the areas where we seek further clarification and guidance from the FRC.

- **Shared ownership**

SMB consider the accounting treatment currently set out in the Housing SORP does not require amendment as a result of changes to FRS102. The substance of the transaction being split between sale of the 1st Tranche and rental on the retained equity remains appropriate. However, since the Housing SORP was last re-written, the government has introduced a new

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model for shared ownership that introduces a 10-year period during which the shared owner will receive support from their landlord to pay for essential repairs. The accounting treatment for which was consulted upon earlier this year. The SMB will incorporate these changes in the updated SORP, whilst not arising from changes from FRED 82.

- Components of a lease contract - service charges

The SMB seeks further clarification from the FRC as to whether service charges linked to an operating lease should be accounted for as a lease component or separately under Section 23.

We note the inclusion of the following paragraphs within Section 20

Separating components of a contract

20.27 A contract may contain multiple components, of which some may relate to the lease of an asset and some may relate to other items such as services. Such components are separated into lease components and non-lease components for the purposes of lease accounting.

20.28 For a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in paragraph 20.33.

However, this does not provide clarity over whether service charges would be classed as a lease component or a non-lease component and should there be different considerations for fixed service charges (which could be considered akin to rent) and variable service charges.

Additionally, we have set out below the scenarios that need consideration for the RP sector. From review of the FRED the resolution to these matters is not clear and we seek further guidance in the standard to ensure that RPs follow appropriate and consistent accounting treatment and reporting.

- Recognition and measurement – Lessor operating leases

20.112 A lessor shall recognise lease payments from operating leases as income on a straight-line basis, unless either:

- a) another systematic basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished; or*
- b) the lease payments to the lessor are structured to increase in line with expected general inflation (based on published indices or statistics) to compensate for the lessor's expected inflationary cost increases. If the lease payments vary according to factors other than inflation, then condition (b) is not met.*

The recognition and measurement guidance proposed raised a number of questions from the SMB.

1. Para 20.112 requires that a lessor shall recognise lease payments from operating leases as income on a straight-line basis unless the lease payments to the lessor are structured to increase in line with expected general inflation (based on published indices or statistics).

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The SMB would seek further clarification from the FRC as there appears to be no guidance on how to account for income if either of the situations presented in para 20.112 exist. This is particularly pertinent for Shared Ownership leases where the rent on the retained proportion is set initially at up to 3% of the value of the share the RP owns and then subsequently increases with a cap on the increase at RPI plus 0.5%. Although with inflation currently at high levels the sector has collectively agreed to cap increases at 7%.

2. The SMB seeks further clarification from the FRC on how to interpret the requirement to recognise income on a “straight-line basis”. With uncertainty and variability in the future rental charges it does not appear appropriate to recognise any changes to rental until such time that they are agreed. As such we would propose that the straight-line period is capped at 12 months for all RPs.

- Life-time tenancies – finance lease?

The SMB agree with the Local Authority Code which states that all social housing tenancies are treated as operating leases and proposes to replicate this conclusion in the Housing SORP.

- Initial direct costs incurred in obtaining an operating lease

The SMB raised some concerns about how the following paragraph may be interpreted by RPs.

20.115 A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognise those costs as an expense over the lease term on the same basis as the lease income.

The SMB considers this is open to judgement that may result in variability in accounting treatment across the sector. This paragraph may be interpreted as allowing the following costs to be capitalised and released over the life of the lease contract:

- Housing officer letting costs
- Administration costs of preparing tenancy agreements
- Repair costs to prepare a void property for let

- Definition of customer

Section 23 (Revenue) applies, with limited exceptions, to all contracts with customers. This has led to two new definitions:

- Contract - An agreement between two or more parties that creates enforceable rights and obligations.
- Customer - A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

FRED82 23.18 goes on to state ‘Promises do not include activities that an entity must undertake to fulfil a contract unless those activities directly transfer a good or service to the customer.’

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It is not uncommon for RPs to contract with a funder (such as a local authority) however the services are delivered to a third party (the beneficiaries). This therefore would not meet the definition of a customer.

We would welcome clarity on such circumstances, in particular whether it would therefore be appropriate to consider such contracts as 'Incoming resources from non-exchange transactions' following the guidance in PBE34.67.

- Discount rate

The SMB welcomes the efforts that have been made to offer simplification and practical expedients particularly in relation to the discount rate.

Question 7: Revenue

FRED 82 proposes to revise the revenue recognition requirements in FRS 102 and FRS 105 to reflect the revenue recognition model from IFRS 15 Revenue from Contracts with Customers. The revised requirements are based on the five-step model for revenue recognition in IFRS 15, with simplifications aimed at ensuring the requirements for revenue in FRS 102 and FRS 105 remain cost-effective to apply. Consequential amendments are also proposed to FRS 103 and its accompanying Implementation Guidance for alignment with the principles of the proposed revised Section 23 of FRS 102. Do you agree with the proposals to revise Section 23 of FRS 102 and Section 18 of FRS 105 to reflect the revenue recognition model from IFRS 15, with simplifications? If not, why not? Have you identified any further simplifications or additional guidance that you consider would be necessary or beneficial?

We note that Section 23 scopes out lease contracts within the scope of Section 20 Leases. As such a large proportion of income for RPs will be recognised in accordance with Section 20 being rental income. We have noted our queries in response to question 6 regarding the appropriate section under which to recognise Service Charge income.

One matter that was raised during the stakeholder engagement phase was the different recognition criteria that currently exists for insurance claims. We note that there has been no change to the wording currently included within paragraph 21.9 which sets the recognition criteria for income from insurance claims only when it is virtually certain. We would ask the FRC to consider how this now interacts with revenue recognition criteria now contained within Section 23.

21.9 When some or all of the amount required to settle a provision may be reimbursed by another party (eg through an insurance claim), the entity shall recognise the reimbursement as a separate asset only when it is virtually certain that the entity will receive the reimbursement on settlement of the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision. The reimbursement receivable shall be presented in the statement of financial position as an asset and shall not be offset against the provision. In the statement of comprehensive income (or in the income statement, if presented) the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

Question 8: Effective date and transitional provisions

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The proposed effective date for the amendments set out in FRED 82 is accounting periods beginning on or after 1 January 2025, with early application permitted provided all amendments are applied at the same time. Do you agree with this proposal? If not, why not?

FRED 82 proposes transitional provisions (see paragraphs 1.35 to 1.60 of FRS 102 and paragraph 1.11 of FRS 105). In respect of leases, FRED 82 proposes to permit an entity to use, as its opening balances, carrying amounts previously determined in accordance with IFRS 16.

This is expected to provide a simplification for entities that have previously reported amounts in accordance with IFRS 16 for consolidation purposes, promoting efficiency within groups. Do you agree with this proposal? If not, why not?

Otherwise, FRED 82 proposes to require the calculation of lease liabilities and right-of-use assets on a modified retrospective basis at the date of initial application. Do you agree with this proposal? If not, why not?

In respect of revenue, FRED 82 proposes to permit an entity to apply the revised Section 23 of FRS 102 on a modified retrospective basis with the cumulative effect of initially applying the revised section recognised in the year of initial application. This is expected to ease the burden of applying the new revenue recognition requirements retrospectively by removing the need to restate comparative period information. Unlike IASB/ED/2022/1, to ensure comparability between current and future reporting periods, FRED 82 does not propose to permit the revised Section 23 of FRS 102 to be applied on a prospective basis. However, FRED 82 proposes to require micro-entities to apply the revised Section 18 of FRS 105 on a prospective basis.

Do you agree with these proposals? If not, why not?

Do you have any other comments on the transitional provisions proposed in FRED 82? Have you identified any additional transitional provisions that you consider would be necessary or beneficial? Please provide details and the reasons why.

The SMB does not believe the proposed changes in this exposure draft are achievable. The impact on RPs is significant and will require an appropriate period of time to prepare adequately. We do not believe that the proposed effective date for the amendments allows sufficient time for preparers to complete the data gathering, assess the impact on their budgets and plans, consider the impact on stakeholders, including lenders, bond holders (many RPs are PIEs with listed bonds on recognised exchanges) and other partners and investors.

In particular, significant work is required due to changes proposed in Section 20, the absence of guidance relating to ESG related spend on PPE, and addressing significant sector accounting developments since the previous FRS 102 triennial review which requires significant SORP amendments – for example relating to building safety and the new shared ownership model. The sector was severely restricted when the previous triennial review took place with lenders enforcing “frozen GAAP” covenants that in some cases, restricted RPs from accessing debt.

We believe that further allowance should be made for the SMB to consider the implications of the changes to FRS102 for the sector, re-write the SORP, and for the SMB to consult with stakeholders prior to the implementation date. At present, the SMB is going to have a

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particularly short period in which to draft the revised SORP and feel there will not be sufficient time to consult and work with the FRC on major changes to the SORP to meet the proposed implementation date.

We expect this challenge will also be relevant across other stakeholder groups, such as Charities and Further / Higher Education. We therefore propose deferring the effective date to 1 January 2026 to allow for appropriate SORP consultations to conclude.

Question 9: Other comments

Do you have any other comments on the proposed amendments set out in FRED 82?

Section 18 - Intangible Assets

We welcome the addition of paragraph 18.3B which reintroduces the previous guidance from FRS 10 in relation to the classification of capitalised costs for software development as either tangible or intangible assets.

We note however the focus in Paragraph 18.4 that ‘...the entity shall recognise an intangible asset as an asset if, and only if: (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity...’

In our response to Question 2, we have already commented on the use of two different definitions within one standard.

Furthermore, like other Public Benefit Entities (“PBEs”), non-profit RPs often do things that do not generate an economic benefit but further the charitable purposes, for example providing access to an online information for tenants, although we recognise that in some cases there can also be a mixed motive to both generate an economic benefit and for delivering charitable purpose.

We consider that the definitions within Section 18 should be widened to include the service potential of the asset as well as future economic benefits.

Question 10: Consultation stage impact assessment

Do you have any comments on the consultation stage impact assessment, including those relating to assumptions, sources of relevant data, and the costs and benefits that have been identified and assessed? Please provide evidence to support your views.

In particular, feedback is invited on the assumptions used for quantifying costs under each of the proposed options (Section 3 of the consultation stage impact assessment); any evidence which might help the FRC quantify the benefits identified or any benefit which might arise from the options proposed which the FRC has not identified (Section 4 of the consultation stage impact assessment); and appropriate data sources to use to refine the assumption of the prevalence of leases by entity size (Table 23 of the consultation stage impact assessment).

No further comments