



Registered Providers of Social Housing: Going concern

A guide for Boards, Audit Committees
and Management



The information and checklist in this document is designed to assist Boards, Audit Committees and Management of Housing Associations in preparing financial statements to report on the financial position of their organisation.

In particular, it will assist them in their responsibilities to assess whether the going concern basis of accounting is appropriate, to consider any judgements or uncertainties in relation to the future solvency and liquidity risks for the registered provider, and to provide clear and concise financial reporting disclosures that meet the statutory and other financial reporting requirements.

Background

Directors of registered providers of social housing have a responsibility to ensure that the association operates as a going concern. While this is a continuing responsibility, it is most relevant when preparing the annual report and financial statements.

While there has been no change to this responsibility the Financial Reporting Council has revised International Auditing Standard 570 Going Concern, which significantly extends auditors' responsibilities. This is in response to recent enforcement cases and well-publicised corporate failures.

In preparing the report and financial statements to comply with Financial Reporting Standard 102 ('FRS 102') and the housing association SORP, the Directors with management, are required to make an assessment of the association's ability to continue as a going concern, as well as determining if there are material uncertainties in respect of going concern. In making this assessment they are required to take into account all available information about the future, covering a period of at least 12 months from the date on which the report and accounts are approved by the Board.

Revised ISA570 means that there will be a shift from a perspective whereby an entity is a going concern unless there are indications to the contrary,

to a position where directors need to show that the entity is a going concern and actively consider any factors that may cast doubt on this. Auditors are now required to demonstrate greater challenge of this assessment.

Key changes to the standard are:

- enhanced risk assessment procedures;
- prescribed procedures that must be performed in relation to forecasts;
- greater scrutiny required of the adequacy and completeness of supporting information used to produce management's assessment relating to going concern;
- a greater emphasis on the appropriateness of disclosures made by management, even in instances where there are no material uncertainties related to going concern; and
- procedures to be performed to identify and evaluate risks of management bias.

Significant changes to the entities operating environment, for example the COVID-19 pandemic, will require the Board to reassess their financial position and the ability of their association to continue to operate as a going concern. This may require considering a number of factors, including updating the association's corporate plan, budgets and forecasts, and should cover any changes up to the date of sign off of the financial statements.

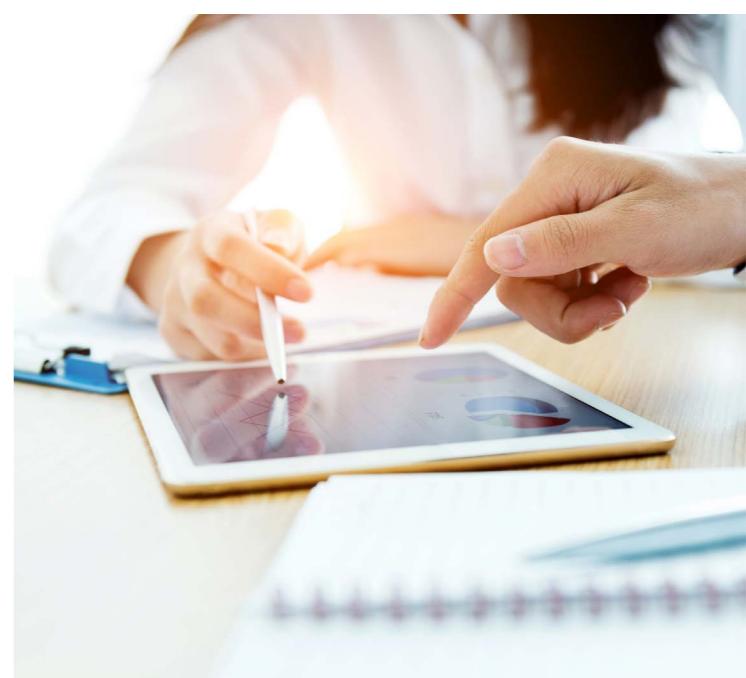
Where Directors identify uncertainties, other than those with a remote probability of occurring, that could lead to the association not being a going concern, they are required to disclose these in the financial statements. The Financial Reporting Council (FRC) has stated that it believes it is likely that more entities will disclose "material uncertainties" to going concern in the current circumstances.

This term may not be widely understood. It refers to uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. In other words, if Boards identify possible events or

scenarios (other than those with a remote probability of occurring) that could lead to corporate failure, then these should be disclosed.

If no material uncertainties are identified, Auditors are now required to make a positive statement in their Audit Report that they have not identified any material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

Many Registered Providers face what are relatively fast-moving changes and it will be important that the Board consider not only the organisation's corporate plan, budgets and forecasts but also the sensitivity analysis and stress testing on these. Key considerations will be around financial risk, cashflow, liquidity, availability and demising of debt and resilience.



Going concern - Basis of accounting and foreseeable future

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the charity is a going concern and will continue its operations for the foreseeable future.

While it is for the Directors to determine what period they consider to be the 'foreseeable future', the minimum period is set within FRS102 as "at least, but not limited to, 12 months from the date on which financial statements are authorised for issue". This means, that where relevant information (such as key events or conditions) is available beyond this initial 12 months, Directors will need to incorporate this into their going concern assessment.

The financial reporting frameworks applicable in the UK generally require the adoption of the going concern basis of accounting in financial statements, except in circumstances where Directors intend to cease operations or to liquidate the entity, or have no realistic alternative to cessation of operations or liquidation. If the going concern assumption is not applicable, an alternative basis of accounting is appropriate.

The term going concern is the defining assumption about the condition of an entity for which adoption of the going concern basis of accounting is appropriate: Accordingly:

- a) the term 'going concern' applies to any entity unless its management intends to liquidate the entity or to cease trading, or has no realistic alternative to liquidation or cessation of operations, and
- b) the term 'ability to continue as a going concern' is equivalent to the term 'ability to continue to adopt the going concern basis of accounting in the future'.

This means that the going concern basis would normally be applicable even when there are uncertainties about events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern in the future. However, such uncertainties are required to be disclosed in the financial statements when they are material.

Going concern – Board assessment and material uncertainties

The nature of the going concern assessments by the Directors of Registered Providers will vary widely between different associations depending on factors such as the financing structure, income sources, extent of any leasing arrangements, committed development programme, exposure to outright sales risk and potentially numerous other factors. It is not therefore possible to have a 'one-size fits all' approach to achieve an acceptable assessment.

Nevertheless, because the going concern basis of accounting is a fundamental principle in the preparation of financial statements, the preparation of the financial statements requires the Board to assess the association's ability to continue as a going concern.

The Board associations' assessment of the association's ability to continue as a going concern involves making judgments, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following factors are likely to be relevant to that judgment.

- The degree of uncertainty associated with the outcome of an event or condition will increase significantly the further into the future an event or condition or the outcome occurs.

- The size and complexity of the association, including the nature and location of its activities and the degree to which it is affected by external factors, will affect the judgment regarding the outcome of events or conditions.
- Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

In determining whether there are material uncertainties, the Directors will need to consider:

- the magnitude of the potential impacts of the uncertain future events or changes in conditions on the association and the likelihood of their occurrence;
- the realistic availability and likely effectiveness of actions that the Directors could take to avoid, or reduce the impact or likelihood of, the uncertain future events or changes in conditions; and
- whether the uncertain future events or changes in conditions are unusual, rather than occurring with sufficient regularity for the Directors to make predictions about them with a high degree of confidence.

Going concern - Insolvency

There are normally two tests of insolvency – the balance sheet test (positive net assets) and the cash flow test. The key issue is, can the organisation pay its debts as they fall due. The cash flow test is of particular importance and a Registered Provider can be insolvent even if it has positive net assets. Careful consideration is required of many factors, such as what values can be realised in time to meet debts and what assets can be used to meet liabilities. Understanding is needed of any restrictive covenants and any associated grant attached to a property.

Directors and shadow directors can be guilty of wrongful trading if they continue to trade and incur liabilities they knew or ought to have known that there was no reasonable prospect of avoiding insolvent liquidation.

Fraudulent trading is also a risk. Section 213 of the Insolvency Act provides that on the application of the liquidator of a company the Court may order that any persons who were knowingly party to carrying on the business of the company with intent to defraud creditors must make a contribution to the company's assets. For a fraudulent trading action, intent to defraud creditors must be proved and the onus of proof is on the liquidator. There must be evidence of actual dishonesty.

For an insolvent Registered Provider, senior management, and not just the Directors, could also be made liable for fraudulent trading. The association should avoid entering into preferential transactions which put another party in a better position to the detriment of other creditors. The court will recognise mitigating circumstances. For example, if the directors took proper steps to minimise the potential loss to the company's creditors.

On 28 March 2020 the government announced changes to the insolvency regime aimed to provide companies breathing space and keep trading through the COVID-19 pandemic. The Corporate Insolvency and Governance Act 2020 brought in a temporary suspension of wrongful trading provisions to remove the threat of personal liability during the pandemic, applied retrospectively from 1 March 2020 and initially to 30 September 2020, now extended to 31 March 2021. In addition, there is a temporary moratorium for companies undergoing a restructuring process so that they cannot be put into administration by creditors and will continue to be able to pay suppliers and staff, although it has been clarified that these measures do not impact the existing laws relating to matters such as fraudulent trading, transactions defrauding creditors and misfeasance.



Going concern - Reporting requirements

The financial reporting standard applicable in the UK and the Republic of Ireland (FRS102) Section 3 requires Directors to make an assessment of the entity's ability to continue as a going concern and when Directors are aware in making its assessment, of material uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. In addition, for entities following International Financial Reporting Standards (IFRS) has a similar requirement.

The housing SORP, which applies to the financial statement of all registered social housing providers does not provide specific guidance or

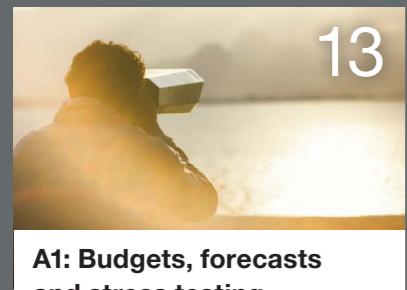
disclosure requirements in relation to going concern. Therefore we look to the underlying accounting framework for our reporting requirements.

We have previously published a Financial disclosure reporting checklist: Charities SORP (FRS 102) which includes all the SORP disclosure requirements, and this checklist is available on our website.

To assist Directors to meet their reporting requirements specifically in relation to going concern, we have summarised as Section B in this document a checklist of the key disclosures that Directors and management will need to consider as part of their going concern assessment.

This checklist is published for general guidance and therefore without responsibility on the part of Crowe U.K. LLP for loss occasioned to any person acting, or refraining from action, as a result of any information published herein.

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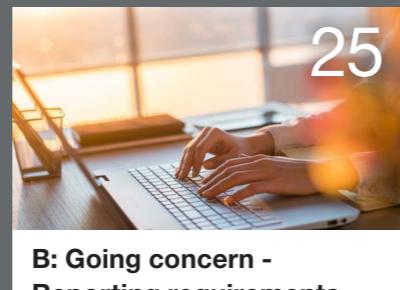
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B: Going concern - Reporting requirements

A. Going concern – Directors' assessment

It will be important in making any assessment of going concern that Directors evaluate whether the association has access to sufficient liquidity and can remain solvent through the period of public health restrictions and beyond.

Directors will need to take into account the association's available reserves, the terms of any financing facilities or other support accessed.

Directors will also need to consider the impact of different potential scenarios on their income, costs (both fixed and variable) asset and liability values and cash flow requirements.

The Governance and Financial Viability Standard Code of Practise highlights that as part of an association's risk management approach, you should be stress testing against different scenarios across the whole group.

Directors should consider how events or conditions that may cast doubt on a subsidiary's ability to continue as a going concern will impact on the group. For example, in relation to onlending, loan defaults and intercompany guarantees.

The stress testing already required by the Regulator of Social Housing will be a valuable part of the going concern assessment but it needs to be robust and consider multivariate analysis.

Liquidity and solvency risks faced by the association may be inter-related and either or both may affect its going concern status and whether it faces material uncertainties related to going concern.

Directors will need to ensure that their assessment of going concern and the evidence that they need to gather in support of that explicitly considers both liquidity and solvency factors which may affect the ability of the Directors to assert that the association is a going concern and to identify related material uncertainties.



A1

Budget,
forecasts
and stress
testing

A1: Budgets and forecasts

Key budget and forecast assumptions

Changes in the operating environment will have had a material impact on many of the future assumptions for most registered providers. It will therefore be very important that these have been appropriately updated.



- Do the financial budgets / forecasts appropriately reflect the latest information available?
- Have all the key assumptions used in the financial budgets / forecasts been updated to reflect the potential impacts on the activities and operating methods of the association? In particular, do they fully reflect known and potential changes to:
 - income streams?
 - fixed and variable costs?
 - activities?
- Do the financial budgets / forecasts adequately reflect changes to asset realisable values, for example:
 - recoverable rent arrears?
 - stock values?
- Have the changes to the operating environment resulted in any key additional liabilities, for example:
 - final salary pension scheme liabilities?
 - onerous contracts?
 - redundancy payments?
 - additional development costs?

Stress tests

Directors will need to consider the potential scenarios for the future activities of the association and it will be important that the financial effects of any and all the potential scenarios are reflected into the financial forecasts.

- Have the budgets and forecasts been updated to address possible scenarios considering both what if and how likely?
- Do the budgets and forecasts adequately reflect the impact from any “what if?” questions that the Directors should consider?
- Is this stress testing explicitly linked to the association’s strategic risk register and the asset and liabilities register?

Key budget and forecast sensitivities

There are many uncertainties and this means that most forecasts will include judgements and estimates. These should be subject to sensitivity analysis. The risk that one change can lead to others and the impact of this can be significant and should be recognised.

- Do the budgets and forecasts provide adequate flexibility to enable the Directors and management to understand the key risks and uncertainties and the related impacts on the financial position of the association from changes to any of the income or costs related to these uncertainties?

Reverse stress testing

Reverse stress tests identify pre-defined outcomes, such as the association’s business model becoming unviable, then explores plausible scenarios that could result in that outcome, this is often referred to as the “perfect storm”. In general terms, reverse stress tests require considering the answer to three questions.

- What would it take for the association to fail?
- What event or combination of events might lead to this outcome?
- What can we do now to avoid this happening?

Government policy

• Housing Associations are susceptible to impacts from changing government policy and the risk of changes needs to be factored into going concern considerations and stress testing. Areas to consider include, rent setting, BREXIT, availability to grant funding, impact of sovereign debt rating on Association's own rating and access to financing, cost of regulation, changes to planning laws and S106, Right to Buy and Right to Acquire policies and changes to the Shared Ownership model identified in the Housing White Paper.

- How reliant is the Association on maintaining status quo?
- Has stress testing considered the impact of potential changes to government policy?

Staff / furlough scheme / redundancies

The Furlough scheme may have allowed the association to retain its staffing structure during the initial lockdown period. Additionally, many organisations are recognising that the current enforced changes in working practices are likely to be at least in part retained going forward. It is important that the forecasts appropriately reflect the impact on the association both of the withdrawal of the furlough scheme support and any other decisions on future staffing that may need to be considered.

- Are the financial impacts of the furlough scheme and its future withdrawal appropriately reflected in the future projections of staff costs?
- Have the Directors identified any necessary changes to the association's current or future staffing structure and have the financial impacts of these changes been fully integrated into the future forecasts?





A2

Future
cash flow
projections

A2: Future cash flow projections

Working capital and liquidity

A key part of a Registered Provider's going concern assessment will be its working capital / liquidity position

- Do the cash flow projections provide the Directors with the information they need to assess the continuing adequacy of the association's working capital / liquidity including any key points of stress?

Linking of cash flow timing and changes to budgets and forecasts

Changes to the Registered Provider's operating environment may require a reassessment of the association's budgets and forecasts up to the date of signing of the financial statements. Additionally, the changes may also impact on the timing of income and expenditure cash flows with cash flows being either later or earlier than previously anticipated. It will therefore be important that the future cash flow projections adequately reflect the potential timing changes.

- Do the cash flow projections reflect the changes made to the budgets and forecasts as well as the additional potential impact of these changes on the timing of the related cash flows?

Potential cash collection issues

Changes to the operating environment will also impact the tenants and local authorities funding care and support services. As a result, amounts that would previously have been received may now be deferred or potentially not recovered. Associations need to also consider the impact of tenants migration to Universal Credit.

- Do the cash flow projections appropriately reflect the potential changes in the timing and amounts that will be received?
- What impact does this have on liquidity?

Cash flows from restricted funds

Charitable Registered Providers with restricted or endowment funds may have cash inflows that are only available to fund activities within the purposes of the restricted funds.

- Do the cash flow projections adequately segregate the association's cash flows, both in and out, between cash available for the unrestricted general purposes and cash which must be used for the limited purposes of its restricted funds?

Commitments and liabilities

Changes to the operating environment may have necessitated a reassessment of the association's priorities and operating requirements. Any such changes may have created and / or reduced the association's ongoing commitments and liabilities as well as the timing of the settlement of these.

- Have all potential changes to the association's future financial commitments and liabilities and related cash flows been appropriately identified and reflected into the cash flow projections?
- Have any building or fire safety rectification costs been factored into financial forecasts?

Loan repayment terms / facilities / headroom / covenants

Changes to the association's operations may impact on its ability to meet its loan repayment terms, in particular if these result in potential breaches to the terms of any related covenants.

- Have the risks of breaching these covenants and the potential impact on the future cash flows and liquidity been adequately reviewed?
- Has any early repayment or refinancing been factored into forecasts?
- Do your Association's own KPIs or "Golden Rules" give early warning to any potential breach?

Asset values

Future cash flows may depend on the realisation of investment or other assets. The value of any such assets at the point of disposal may therefore be a key input to the going concern assessment.

- Do the Directors have sufficient information to assess the key assumptions that have been used to determine the valuations?
- Has the relative probability of different outcomes been adequately assessed?
- Where valuations rely on external experts, do the Directors have sufficient information to ensure that the values are appropriate?





B

Reporting requirements



B. Going concern – reporting requirements

In making their assessment of going concern, where the Directors are aware of material conditions that cast significant doubt upon the association's ability to continue as a going concern, they are required to disclose those uncertainties in the association's annual financial statements.

Additionally, disclosure is required giving details of the nature of any material events that occur after the balance sheet date with an estimate of their financial effect.

Should the Directors conclude that it is not appropriate to prepare the financial statements on a going concern basis, they are required by FRS102 to disclose this fact, together with information to explain the basis on which the financial statements have been prepared and the reason why the entity is not regarded as a going concern.

The sections below are an extract of the relevant disclosures required on going concern, uncertainties and key judgements and assumptions from our FRS 102.

B1: Directors' Report - Going concern

If, at the date of approving the report and accounts, there are uncertainties about the association's ability to continue as a going concern, the nature of these uncertainties should be explained.

B2: Directors' Report - Principal risks and uncertainties disclosures

The strategic report should provide:

- a description of the principal risks and uncertainties that the Directors see as facing the Registered Provider and any subsidiaries, summarising the Directors' "plans and strategies for managing those risks"
- any factors that are likely to affect the associations' future prospects and the financial performance or position going forward.

FRS 102
3.9

HOUSING
SORP
4.6

B3: Notes to the Accounts - Going concern material uncertainties

Registered Providers must explain in the notes to the accounts any material uncertainties related to events or conditions that cast significant doubt on the entity's ability to continue as a going concern. In making this explanation, Registered Providers should provide:

- a brief explanation of those factors that support the conclusion that the association is a going concern; and
- a balanced, proportionate and clear disclosure of any uncertainties that makes the going concern assumption doubtful.

For accounts not prepared on a going concern basis, this fact MUST be disclosed, together with the basis on which the accounts are prepared and the reason why the association is not regarded as a going concern.

Deterioration in operating results and financial position after the separating period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this section of FRS requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting and therefore the disclosure requirements of paragraph 3.9 apply.

FRS 102
8.2

B4: Notes to the Accounts - Going concern no material uncertainties

Where there are no material uncertainties about the association's ability to continue, this should be stated in the notes to the accounts.

FRS 102
8.2

B5: Notes to the Accounts - Key judgements and assumptions

- the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the accounts
- the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period
- in respect of those assets and liabilities where there is a significant risk of material adjustment within the next reporting period, the notes MUST include details of their nature and their carrying amount as at the end of the reporting period.

FRS 102
8.6
and
8.7

B7: Post balance sheet non-adjusting events

For each category of non-adjusting event, the notes to the accounts MUST provide details of the nature of the event and an estimate of its financial effect or a statement that such an estimate cannot be made.

FRS 102
32.10

Start the conversation

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