Coronavirus: financial reporting considerations for housing associations

Crowe Non Profits team

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The impacts and responses to COVID-19 are continually developing. This is the interpretation of considerations needed for financial reporting at the time of writing this guide. We will update this guidance periodically as relevant guidance and best practice materialises.

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This update considers the potential impact of the new COVID-19 (coronavirus) on the yet to be published annual reports and financial statements of housing associations.

The measures put in place by the Government to limit the spread of the virus have been changing on a daily basis. It is expected, at least in the shorter term, the limiting of the movement of people will continue and may even increase.

All of these developments and measures may have a broad range of implications for housing associations. The degree of impact on individual associations will depend on a number of factors including the association's mix of rental, outright sales and shared ownership, the level of developments ongoing, contractual relationships, whether or not care is provided, staffing models, insourcing or outsourcing of repairs and maintenance, the nature of the association's assets and liabilities and the association's cash reserves.

The Board will already be dealing with unexpected challenges and focusing on the health and wellbeing of tenants and staff. Whilst this is the key priority it will be important that these response actions are reflected into the necessary decisions that have to be made when reporting on the association's activities and financial position.

The FRC has confirmed that Companies House may grant extensions to reporting deadlines and this is similarly true of the Charity Commission however the Regulator of Social Housing has not taken steps to echo this flexibility as there are no provisions in the Housing Regeneration Act 2008 to allow this.

Areas of focus

The key areas of focus of this update are as follows:

Key messages

Management and the Board will need to carefully consider the impact of coronavirus on the association's annual report and financial statements to ensure that these continue to reflect the financial activities and position of the association in accordance with the Housing SORP and The Accounting Direction for Private Registered Providers of Social Housing.

- Assets where the value has suffered an impairment will need to be reviewed and the impairment reflected in the financial statements this is particularly important to consider for properties under construction and properties recognised at market value.
- Associations will need to review debtors and rental arrears to determine if the third parties remain in a position where they will be able to settle the amounts due or whether there is a need to write down the carrying amounts.
- Borrowings need to be considered by the association to ensure that it is not in breach of any related terms and covenants.
- Most organisations, including housing associations, are having to change their working structures in the short term as a necessity. If these prompt a longer-term change in use of resources, then onerous contracts in respect of leasehold properties will need to be assessed.
- Narrative reporting will need to explain the effects of the corona virus on the association and how this impacts on financial position and plans going forward.
- The Annual Report should be balanced and comprehensive to give stakeholders sufficient information to appropriately assess the performance of the association and highlight any uncertainties in estimates and judgements.
- The Board assessment of the association's financial viability and ability to continue as a going concern is already a key area of emphasis and importance and the Board will need to take particular account of the impacts from the coronavirus outbreak and ensure they have the appropriate disclosures. This may also lead to a modified audit report.
- For each entity in the group Directors will need to consider the ability to continue as a going concern. They should consider support from elsewhere with the group and whether this is still sufficient.
- The government has already implemented a number of business support schemes, some of which will be available to housing associations and / or their trading subsidiaries depending on their circumstances. This is constantly changing and the details of entitlement and how any claims will be settled are still being developed. However, if an association believes that it can benefit from any of these support schemes the Board will need to determine when and how any such benefit should be reported in the financial statements.

Commitments and liabilities

The general rule for recognising liabilities is set out in FRS 102 para 2.39 and requires that "*An entity shall recognise a liability in the statement of financial position when:*

(a) the entity has an obligation at the end of the reporting period as a result of a past event;

(b) it is probable that the entity will be required to transfer resources embodying economic benefits in settlement; and

(c) the settlement amount can be measured reliably."

A legal obligation arises when an association enters into a binding contract or there is a statutory requirement to make a payment and the expenditure is normally recognised once the supplier of the goods or services has performed their part of the contract. A constructive obligation arises as a result of an associations actions when it indicates to other parties that it accepts particular responsibilities and thereby creates a valid expectation on their part that the association will meet them.

Redundancies

In a difficult economic environment and facing difficulties in obtaining financing, an association may be considering or implementing restructuring plans including employee redundancies.

Where a Board decision has been taken to restructure and make redundancies (as opposed to furloughing employees) and has raised a valid expectation in those affected by it prior to the reporting date the financial statements should recognise a restructuring provision.

Leases and onerous contracts

One impact of the coronavirus is that most organisations, including housing associations, are necessarily having to change their working structures in the short term. Whilst this may be temporary, for some this may prompt a longer-term change which may in turn change the resources needed by the association.

In reviewing the current and ongoing plans for the association, the Board may identify that certain leasehold properties or other contracted facilities or services will not be needed by the association to meet its future plans. In this event, to the extent that the association is not able to extract itself from the relevant leases or other contracts by cancellation or other means, it may be necessary to consider if provisions are required in the financial statements on the basis that these have become onerous contracts.

Financial instruments

Associations should review financial instruments to understand and identify the implications to them and their reporting from the reduction in base interest rates, movements in foreign currency exchange rates, and any other relevant factors which may potentially impact on the fair values of these financial instruments.

The Board should also assess whether there is any impact on hedging arrangements including evaluating whether forecast transactions designated as hedged items in cash flow hedges continue to be highly probable and determine whether any changes in the contractual terms of a hedged financial instrument resulting from the COVID-19 outbreak affect the instrument's eligibility to be a hedged item.

Pension liabilities

The financial statements requirements for DB scheme accounting and disclosures by housing associations which continue to have defined benefit liabilities remain unchanged and are set out in Section 28 of FRS 102. These require the association to report the net defined benefit liability (being the present value of the scheme obligations less the fair value at the reporting date of the scheme assets) and the change in this liability during the period.

There are many areas to consider and the estimates and judgements made in the assumptions used can have a large impact on the final result. Care will need to be taken to consider matters such as whether current bond rates and yields properly reflect the nature of the scheme. For example, liabilities are often assumed to be of the same term as the maturity of the bond index. The reality is that most pension schemes are normally of a much longer term nature.

There is already much comment on the impact of coronavirus on pension schemes, and in particular for employers who continue to be the sponsors of defined benefit (DB) schemes. The key short-term issue is likely to be the increase in the net liability, mainly due to a fall in the investment values, and how this is presented and explained in the Annual Report and the financial statements. In the longer-term actuaries may need to reassess other assumptions in their actuarial valuations including overall life expectancy and these assumptions are likely to become an area that will need increased focus for the Board both in the valuations for financial reporting and in assessing the required future contribution rates.

For any associations for which cash flows are an immediate issue, initial guidance has already been published by the Pensions Regulator including Guidance for DB scheme Trustees whose sponsoring employers are in corporate distress. The guidance is currently brief but includes short comments on areas such as the deferral of deficit repair contribution (DRC) payments.

Associations will also need to consider the impact of McCloud judgements and GMP and further guidance has been issued by the National Housing Federation on these matters and the financial reporting implications.

Asset values/impairment

Perhaps one of the initial most obvious financial impacts of coronavirus has been the fall in value of the financial markets. However, there are also other assets where the value has suffered an impairment and it will therefore be important that the Board review the assets of their association to identify if any such impairment has occurred and ensure that this is reflected in the financial statements.

Social Housing properties

FRS 102 and the Housing SORP provide indications that should be considered but highlight that the list is not exhaustive. Whilst 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 have imposed restrictions that are having a material impact on the nation's ability to work. Housing secretary 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 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 COVID-19 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; and
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; and
- 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 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).

Assets under construction

As a result of movement restrictions, isolation and social distancing, many construction sites have had to halt development and temporarily close. Costs incurred during this pause will need to be considered carefully as to whether they should be capitalised as part of the development cost or expensed to the Income and Expenditure account.

FRS 102 para 25.2D requires that an entity "suspend capitalisation during extended periods where active development of the asset has paused."

Costs such as site security, development staff etc will also need to be considered as to whether this constitutes "costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management" in accordance is FRS 102 para 17.10.

Debtors receivable

As a result of COVID-19 it is highly likely that rent arrears will increase, especially for tenants not in receipt of housing benefit. The Board should consider the recoverability of debts at the reporting date and up to the date of signing and conclude on whether any bad debt provision or write off of debt (may be a consideration if there is a death of tenant).

Insurance/contingent assets

Associations that hold insurance policies may be able to claim for certain costs or losses and may have either a contingent asset for these claims if not agreed with the insurer or an actual asset which may be recognised if agreed by the insurer.

For accounting purposes FRS 102 para 2.38 requires that "*An entity shall not recognise a contingent asset as an asset. However, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate*."

Going concern

The Board assessment on the association's financial viability and ability to continue as a going concern is already a key area of emphasis and importance. At the current time those assessments and reporting need to take account of the impacts from the coronavirus outbreak. The Financial Reporting Council thinks it is Dolikely that more companies will disclose 'material uncertainties' to going concern in current circumstances.

FRS 102 para 3.9 require that when management is 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. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

The impact of the coronavirus outbreak will require all entities, including housing associations to stress test business plans, reassess their financial position and future viability and their ability to continue to operate as a going concern. This will require consideration of a number of factors and assessment of alternative scenarios as there are many uncertainties arising from COVID-19.

Business plan, budgets and forecasts

For financial reporting purposes FRS 102 para 3.8 requires that the Board, when preparing financial statements, make an assessment of the entity's ability to continue as a going concern. An entity is a going concern unless the Board intend that the association will cease its activities, or has no realistic alternative but to do so.

In assessing whether the going concern assumption is appropriate, the Board are required to take into account all available information about the future, *which is at least, but is not limited to*, twelve months from the date when the financial statements are authorised for issue.

For most associations business plans, budgets and forecasts will, at least initially, have been prepared based on the previous normal and will not reflect the most recent developments. Clearly associations will need to update their forecasts in light of the changed circumstances, but this may be difficult given the current level of uncertainties in relation to what actions and restrictions will be necessary going forward and the possible impact of these on the association's future income and operations. Careful consideration should be given to extending the preparation of budgets or forecasts to a period exceeding one year from the sign off of the financial statements, to properly reflect the on-going challenges arising from addressing the pandemic challenges.

This list is not exhaustive but Boards should consider the following when revising and stress testing business plans:

- Loan covenant compliance;
- Timing of cashflows from rent arrears, property sales, staircasing;
- Voids and potential increases due to delays in remedial works, ability to move in new tenant or death of tenants;
- Timing of repairs and maintenance;
- Additional costs of development due to delays;
- Potential costs savings such as travel and subsistence; and
- Timing of discretional spend such as capital works, IT, energy efficiency improvements etc.

Hopefully some clarity will emerge as time progresses, but it will be important that the Board continue to review and update their financial forecasts as developments occur and the impacts on the association become clearer.

Covenants

Where changes to the financial results, position of an association or valuation of security cause a breach in a housing association's 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 para 11.47 and may need to reclassify debt as due within one year. This should be considered carefully as part of the going concern review.

Other financial statements disclosures

Post balance sheet events

The recent coronavirus developments are likely to impact on the reporting by housing associations which have reporting dates in both 2019 and 2020. One key area for possible judgement will be the effective dates of any events which will determine whether or not adjustments should be recorded in the financial statements.

For year-ends up to 31 December 2019 the general guidance is that the financial impacts resulting from coronavirus will be from events post the year-end date and that these will therefore be non-adjusting events. However, an association may still need to reflect other adjusting events after the end of the reporting period as adjustments to the financial statements. As examples:

- If a debtor which was previously considered as “good” as at 31 December 2019 is subsequently determined to be irrecoverable after the year-end because of the impact of coronavirus, then this will in most cases be a non-adjusting event with no adjustment to the carrying value being made. For any material amounts the change in recoverability post the year-end should be reported in the notes to the financial statements. It will also be important that the changes in recoverability are fully reflected in any going concern review by the association.
- Alternatively, if other information becomes available after the year-end which indicates that a debtor previously considered as “good” as at 31 December 2019 was not actually recoverable as at this date, then the debtor will probably need to be adjusted. This should be in line with the normal debtor provisioning reviews carried out by associations at previous year-ends.

The Financial Reporting Council in their ‘Company Guidance Update March 2020 (COVID-19), explain: *“There is a general consensus that the outbreak of COVID-19 in 2020 was a non-adjusting event for the vast majority of UK companies preparing financial statements for periods ended 31 December 2019. Companies will need to judge how much of the impact of COVID-19 should be considered to arise from non-adjusting events for subsequent reporting dates. This will be highly dependent on the reporting date, the specific circumstances of the company’s operations and the particular events under consideration.*

In reaching this judgement, companies will need to focus on the importance of the conditions at the balance sheet date – does the event shine a brighter light on those conditions or did conditions change after the reporting date? If the judgement had a significant effect on the amounts in the financial statements, then this judgement should be disclosed and explained.

If an event is considered to be non-adjusting, then the nature of the event should be disclosed. Where an estimate of the financial effect on the company can be made, then this should be disclosed. Otherwise the fact that the financial effect cannot be estimated should be disclosed. The estimate does not need to be exact – a range of estimated effects is better than no quantitative information at all. In the absence of any quantitative estimate, a qualitative description should be provided.”

For 31 December 2019 year ends, the Board should therefore focus on the disclosure of the impact of the coronavirus outbreak on the financial position of the association, its results for the period and future financial viability.

For March 2020 year ends the impact of COVID-19 will be an adjusting event and therefore should be considered when preparing the financial statements. In particular consideration should be given to impairment, recoverability of debtors, valuation of assets and going concern.

Accounting policies

The financial statements should set out in the accounting policies used that are relevant to an understanding of the financial statements and the measurement bases used in preparing them.

The Board are required to reassess their accounting policies each year as part of the financial reporting. While most accounting policies are likely to remain appropriate, to take account to the coronavirus outbreak certain specific areas have been identified for potential review above.

Key judgements and estimation uncertainty

FRS102 para 8.6 requires that an entity shall disclose, along with its significant accounting policies or other notes, the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.
An entity shall also disclose in the notes information about 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 financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature; and

(b) their carrying amount as at the end of the reporting period.

In the current environment of uncertainty, it will be necessary for the Board to make a number of specific judgements, assumptions and estimates concerning the future in relation to various issues including potentially asset values, liabilities and income receivable. The Board will need to consider the extent that disclosure of these is necessary to comply with the above FRS 102 requirement. The Financial Reporting Council is encouraging *"companies to provide as much context as possible for the assumptions and predictions underlying the amounts recognised in the financial statements, irrespective of any narrow interpretation of the requirements. Such information will help users to understand the amounts presented."* In their guidance issued recently they explain:

"Relevant judgements and assumptions might include the:

- *availability and extent of support through government support measures that have been announced;*
- *availability, extent and timing of sources of cash, including compliance with banking covenants or reliance on those covenants being waived;*
- *duration of social distancing measures and their potential impacts.*

In the absence of any consensus view of the future path of the COVID-19 pandemic and its impact on the economy, users cannot expect all companies to apply consistent assumptions when there is such uncertainty. This lack of consistency makes the need for full disclosure of judgements, assumptions and sensitive estimates significantly more important than usual."

Narrative reporting

The Housing SORP states that the objectives of the narrative reporting are:

- to provide information on the social landlord and insight into its main objectives and strategies and principal risks it faces; and
- to complement, supplement and provide context for the related financial statements.

The Accounting Direction for private registered providers of social housing 2019 goes on to state that the report should provide a balanced and comprehensive but concise analysis consistent with the size and complexity of the business of the:

- development and performance during the financial year, including an assessment of the business model used and key financial and non-financial indicators
- effects of material estimates and judgements upon reported performance
- principal risks and uncertainties facing the housing association, including factors arising from subsidiaries or joint ventures
- main trends and factors underlying the development, performance and position of the housing association (or Group) and which are likely to affect it in the future.

In each of these areas the Board will need to consider and report on the impact of COVID 19 on the association. Some of the areas for consideration in reporting include the impact on

- loan covenant compliance and any changes to funding arrangements;
- development plans and future pipeline;
- financial results and position at reporting date;
- cashflow and liquidity;
- pension liabilities;
- operational arrangements;
- going concern assessments;
- future plans; and
- internal controls.

Governance and Financial Viability Standard

Housing associations are also required to certify compliance with the Governance and Financial Viability Standard within the financial statements and any non-compliance identified since the previous report should be explained. The Board should consider whether there has been any impact from COVID 19 on compliance.

Government support

The government has already implemented a number of business support schemes, some of which will be available to associations and/or their trading subsidiaries depending on their circumstances. The current support announced includes:

- Coronavirus Job Retention Scheme
- Deferring VAT and Income Tax payments
- A Statutory Sick Pay relief package for small and medium sized businesses (SMEs)
- A 12-month business rates holiday for all retail, hospitality, leisure and nursery businesses in England
- Small business grant funding of £10,000 for all business in receipt of small business rate relief or rural rate relief
- Grant funding of £25,000 for retail, hospitality and leisure businesses with property with a rateable value between £15,000 and £51,000
- The Coronavirus Business Interruption Loan Scheme offering loans of up to £5 million for SMEs through the British Business Bank
- A new lending facility from the Bank of England to help support liquidity among larger firms, helping them bridge coronavirus disruption to their cash flows through loans
- The HMRC Time To Pay Scheme

All of this is very new and is constantly changing and the details of entitlement and how any claims will be settled are still being developed. However, if an association believes that it can benefit from any of these support schemes the Board will need to determine when and how any such benefit should be reported in the financial statements.

Gift Aid payments from non-charitable trading subsidiaries

It is now well recognised that the Companies Act requires that a payment from a company to its member(s) can only be made if there are sufficient distributable profits. Whether or not a distribution may be made within the terms of the Companies Act is determined by reference to a company's 'relevant accounts'. For most subsidiaries these would be the last audited accounts.

However, as well as the statutory rules about distributions in the Companies Act, directors need to bear in mind that certain aspects of the common law apply to distributions. The most important rule here is that a company cannot lawfully make a distribution out of capital and must consider this both at the time of proposing the distribution and at the time it is made.

Directors should consider whether distributable profits have been eroded by subsequent losses after the date at which the relevant accounts were prepared. This means that directors must also consider whether the company will still be solvent following the proposed distribution. They should consider both the immediate cash flow implications of the distribution and the continuing ability of the company to pay its debts as they fall due. So if they know that asset values have eroded – for example because a debt has to be written off - they would need to consider this.

Start the conversation

Julia Poulter
Partner, Non Profits
and Head of Social Housing
020 7842 5216
julia.poulter@crowe.co.uk

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