



# Grant Thornton

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Dear Joseph

## **Invitation to comment on proposed update of 2008 SORP for Social Landlords**

We are grateful for the opportunity to comment on the proposed update to the 2008 SORP. Our comments should be viewed in the context that Grant Thornton UK LLP is a leading financial and business adviser in the social housing sector supplying services to over 100 external and internal audit clients with a significant range of size and diversity.

We strongly support the need for changes to the SORP to reflect the full requirements of UK GAAP. However, we emphasise that the focus should be on making important/essential, rather than superfluous, changes and caution against revisions to the SORP becoming overly prescriptive. This is in view of not only the differences between associations, but also the impending likely changes required as a result of the ASB's consultation on the future of UK GAAP. We would welcome additional clarification and guidance within the technical notes to establish the level of authority ascribed to the notes and to enhance the proposed SORP changes.

Whilst not specifically referred to in either the SORP update or technical guidance we would be interested in views on how social landlords might reasonably account for future expenditure on properties, on top of any component accounting that may apply. In particular, would social landlords be expected to demonstrate an enhancement of economic benefits of the property where expenditure is required to support the green agenda and yet does not meet the criteria of a separate component? If so, how, in practice, might this be achieved?

Included within the appendix to this letter are our responses to your specific questions.

If you would like us to amplify our comments or views please contact Arthur Merchant ([arthur.merchant@gtuk.com](mailto:arthur.merchant@gtuk.com)) or Jenny Brown ([jenny.m.brown@gtuk.com](mailto:jenny.m.brown@gtuk.com)).

Yours sincerely

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For Grant Thornton UK LLP

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## **Capitalisation of works to existing properties**

- 1 The SORP Working Party has consulted on the applicability of component accounting and has prepared a draft Technical Note that provides further guidance on this area.

**Are consultees of the view that existing guidance in the SORP over the capitalisation of works to existing properties requires updating, specifically to provide a clearer link to the adoption of component accounting?**

We agree that further clarification is required for accounting for subsequent expenditure to properties, including component accounting. We agree with the principles behind the update although we recognise that it will mean some significant practical implications for social landlords very close to the outcome of the ASB's consultation on the future of UK GAAP.

In our view, a key issue will be to ensure the requirements are easily understood and interpreted in a manner appropriate for different social landlords. Our comments on the proposed amendments are set out in response to question 2 below.

- 2 **If yes, do consultees agree with the proposed amendments in relation to works to existing properties? If not, why not and what alternatives do consultees support (with reasons)?**

We welcome some amendment to the guidance on works to existing properties and depreciation. However, we believe there is scope to simplify the requirements so they are more easily understood and interpreted, either in conjunction with, or without, the proposed supplementary guidance.

Our detailed comments on these amendments are as follows:

The existing guidance should clarify 'generally existing accounting practice in accordance with FRS 15' (SORP paragraph 125). We suggest paragraph 125 could emphasise the general requirement that works to existing properties are charged to the income and expenditure account unless they meet one of the three circumstances (when they should be capitalised). We suggest the following changes to the paragraph:

*Social landlords should follow generally accepted accounting practice in accordance with FRS 15 in deciding which items are capitalised and which items are charged against the income and expenditure account. Items should be charged to the income and expenditure account unless they result in an enhancement of the economic benefits of a property (either as a new asset or the replacement of an existing component). There are three applicable.....*

The three circumstances outlined could then be lifted straight from FRS 15.

This would then result in paragraph 135 becoming redundant. We have some concern about the use of 'or' in this paragraph in the phrase '*do not replace a component or result in an enhancement of economic benefits*' as this may lead to items being capitalised that replace a component but provide no ongoing economic value.

The draft technical notes state that component accounting is not applicable where the rights and obligations towards improving the property reside with the leaseholder/tenant rather than social landlord eg shared ownership properties. We suggest that reference is made to this circumstance in the SORP itself.

The draft technical notes also consider the impact of first time full application of component accounting. We propose that a comment on first time adoption be included in the SORP to give additional clarity to expectations regarding prior year adjustment, particularly in relation to the consideration of previous years' capital versus revenue decisions.

Paragraphs 170 and 171 are recommended practice in the SORP and we believe that the amendment to paragraph 170 (last sentence relating to component accounting) could be highlighted by including it as a third paragraph of recommended practice (a new paragraph 172). In our view the requirement to properly consider component accounting would be emphasised if included in this way, as a separate paragraph. We suggest that the reference to paragraph 126 (within the new paragraph 172) and the inclusion of 'and other components' in paragraph 171 are removed.

### **Treatment of negative goodwill.**

**3 Are consultees of the view that existing guidance over the recognition of negative goodwill requires updating in the SORP?**

Yes.

We believe that, to achieve the improvements in consistency and transparency intended, the application of the requirements for negative goodwill should be retrospective, with any previous business combination now meeting the relevant criteria being credited to the Income and Expenditure account as a prior year adjustment.

We do have some concern that there may be difficulties in the selection of an appropriate amortisation rate where the assets obtained as part of the business combination have a wide variety of useful economic lives under component accounting. We recommend that the more detailed guidance in the technical notes include commentary on how this might be addressed.

**4 If yes, do consultees agree with the SORP Working Party's proposals for accounting for acquisitions that are, in substance, gifts? If not, why not and what alternatives do consultees support (with reasons)?**

We agree with the proposed approach.

**5 Do consultees consider that there are tax implications arising from recognising gains from acquisitions that are, in substance, gifts in the income and expenditure account in the year of acquisition?**

We consider that there would be no significant tax implications arising from the recognition of an acquisition as a gift.

### **.Date from which effective**

6 The proposed effective date is for accounting periods beginning on or after 1 April 2011. Early adoption is encouraged, although retrospective application of the requirements for negative goodwill is not mandatory.

### **Do consultees agree with an effective date of 1 April 2011 for this proposed Update of the 2008 SORP?**

We agree that this would appear to be the most appropriate date as it would allow sufficient time to address any information requirements that may exist. To delay any later than this date could result in changes being made at the same time as the planned transition date for IFRS adoption into UK GAAP.

We recommend that any references to past practice (for example first sentence para 247) are removed or clarified to show when the statement was relevant to avoid the commentary becoming quickly out of date.

See question 3 for our comments on the retrospective application of the requirements of negative goodwill.

### **Additional comments on technical notes:**

The guidance contained within the technical notes is useful and provides an additional source of information for organisations when considering the issues covered. However, we note that whilst these technical notes are not part of the SORP, and not reviewed by the ASB, they include terms such as 'should' and 'ought' which imply that they are definitive. We would welcome clarification as to the format in which these notes will be published and in particular whether they supercede or enhance existing 'Guidance on depreciation and impairment accounting for registered social landlords' (NHF, updated March 2009).

The notes contain a considerable amount of detail which may add an unintended level of prescription in an accounting environment which follows principles based accounting. To highlight our thoughts on the level of detail we question whether asocial landlord that, whilst complying with all the provisions of the revised SORP, does not follow the detailed guidance given in the technical note would be deemed as non-compliant with the SORP? The inclusion of a larger number of examples may provide the required level of guidance without appearing prescriptive, although we acknowledge this could prove cumbersome.

Several references 'to discussions with auditors' are included in the notes. Where the requirement for judgment is being so clearly acknowledged we suggest that the notes include guidance on factors to be considered. In our view this would increase sector-wide consistency.

We also note that there are some minor typographical errors in the text of the technical notes.

### **Component accounting**

The context paragraph (A2) repeats a number of points made elsewhere in the guidance note and could be removed without detracting from the guidance. In particular, para 126 of the SORP goes further than the guidance and includes the requirement for major components to have substantially different useful economic lives, which is a key consideration when assessing the potential impact of component accounting. The assertion that very few social landlords have applied component accounting in full will age the guidance and could be removed - alternatively the guidance would need to be updated and published annually.

In A3 the first sentence states '*examples of components of housing properties held by social landlords that will have a different life*' we suggest that 'will' be replaced with may as this otherwise reads as a prescriptive requirement as opposed to a list of areas for consideration.

We appreciate that the bracketed comment '*with the exception of land*' in A3 may be intended to ensure that land is not depreciated. However, a separate sentence re-stating that land is assumed to have an infinite useful economic life and therefore would not normally be depreciated would, in our view, be clearer.

The guidance on application of component accounting for shared ownership properties will be of interest for many housing associations. However in the draft guidance the relevant paragraph (part of A3) splits the list of components and related guidance and we suggest the paragraph commencing '*Component accounting is not applicable ...*' is moved to the end of section A2 in order to give it greater prominence.

We support the focus on a '*commonsense approach*' (A4 para 2) and suggest that A4 para 3 is reworded to give it a more practical focus as follows: '*In identifying the most appropriate useful economic lives for components, consider asset management strategies, stock condition data and expected replacement cycles.*'

We suggest that the reference to '*recalculate depreciation*' is removed (A4 para 3) unless the presumption is that an annual review of useful economic lives of components may result in recalculation of depreciation charge.

In our view the third sentence of A5 para 1 is incorrect as we are aware that for some new build schemes cost data may be broken down into components by developers. We suggest alternative wording for the paragraph as follows: '*Actual/empirical cost data should be used where it is available. However, where this is not the case practical assumptions will need to be made based on industry data, for example RICS data on build costs.*'

We suggest that A6 should offer social landlords the choice of how grant is allocated and that the approach should be applied consistently across their housing properties.

We do not agree with the assertion in the first sentence of A7 that FRS 15 is clear that component accounting also applies to social landlords that account for housing properties at valuation. The use of depreciated replacement cost for '*subsequent expenditure to properties held at valuation*' seems to be appropriate for those cases where the '*adaptation works*' have a low or nil market value due to their specialised nature and if this is the case we question whether component accounting would be appropriate (as by implication they are not material components). For those social landlords wishing to apply component accounting for housing properties it would seem most appropriate to apportion the valuation against different components, with the usual considerations of materiality being applied.

The contextual information at A8 states that a prior period adjustment would only be required where a material difference exists in the treatment of costs on component accounting. However, in Example 2 on the application of component accounting the driver behind the calculation of the prior period adjustment is not clear, particularly as there is no comment on the assessment of materiality. We believe the example in its current form may lead to a general assumption that the application of component accounting will automatically lead to a prior period adjustment, which is clearly not the case.

At the end of the first paragraph of A8, the final sentence refers to the circumstance referred to in example 3 as '*re-lifing*'. We suggest it would be useful to use the term in this sentence to make the link to the example clearer, as follows: '*Where the adoption of component accounting leads only to a revision of the useful economic life of an asset ('re-lifing'), resulting in a different depreciation charge going forward, there would not be a prior period adjustment.*'

### **Impairment**

We assume that this technical note will enhance, rather than replace, the current guidance on 'Depreciation and impairment accounting for registered social landlords' (NHF, updated March 2009).

In A5 on landbanking the guidance usefully confirms two specific points relating to net realisable value and treatment as a fixed or current asset. However the reference to '*sellable*' value is unclear - does this mean '*market value*' or a market value that has been adjusted, for example for restrictions over use? We suggest it would be helpful to clarify this point.

We have no other comments on this technical note.

### **Business combinations**

Whilst we understand that the intention of the technical note is to encourage consistency across the sector in respect of accounting for business combinations we note that in practice each combination is unique. Therefore, whilst the guidance within the scenarios will assist organisations to interpret the requirements of FRS 6 and the SORP, we think it important to stress that in many instances there will remain a significant amount of judgment, both in respect of the intricacies inherent in each combination and the relative merit attached to conflicting indicators.

We question why, within the technical note, no reference is made to the caveat within Paragraph 235 (a) of the SORP, which states that size may not be applicable in all circumstances, or Paragraph 240, which provides further guidance in this respect. This is also not addressed within the detailed scenarios, which seems to give a significant weight to the relative sizes of the organisation.

Although financial strength may be relevant in some circumstances we believe that this should only be in the context of the criteria set out in FRS 6.

The guidance on business combinations focuses on the differences between merger and acquisition accounting and yet the key change in the SORP update is the introduction of the 'gift of assets' under acquisition accounting. We would welcome further guidance on how, in practice, social landlords can assess whether a combination is in substance a 'gift of assets'. For example should social landlords consider whether or not staff and/or IT systems and/or pensions liabilities are transferring?