



Financial Reporting Council

Feedback Statement and Impact Assessment

**Practice Note 14:
The Audit of Housing Associations
in the United Kingdom**

Introduction

The Financial Reporting Council (FRC) is committed to acting as a proportionate and principles-based regulator and balances the need to minimise the impact of regulatory requirements on business, while working to support the delivery of high-quality audit and assurance work, to maintain investor and wider stakeholder confidence in audit.

The International Standards on Auditing (UK) (ISAs (UK)) are based on the corresponding international standards issued by the International Auditing and Assurance Standards Board (IAASB). Where necessary, the international standards have been augmented with additional requirements to address specific UK legal and regulatory requirements; and additional guidance that is appropriate in the UK national legislative, cultural, and business context.

The FRC also issues practice notes to provide auditors with guidance in specific sectors where there are special considerations unique to entities operating within that sector, for example, where there is significant regulation of an entity's activities.

Practice Note (PN) 14 provides sector specific guidance on applying the ISAs (UK) to the audit of housing associations. Housing associations are private sector bodies who generally provide affordable housing at below-market rate rents & offer individuals who might otherwise struggle to purchase their homes, an opportunity to do so.

Housing associations provide large numbers of, sometimes vulnerable, individuals and families with homes and any financial difficulty within, or even failure of, a housing association could have a significant detrimental impact. High-quality audits, which a revised PN14 assists in achieving, aid in providing assurance on entities on which large numbers of people rely for their housing, a matter of clear public interest. Housing association financing also includes direct investment from pension funds, the safety of whose investments are clearly of wider public interest

PN 14 was last revised in 2014 and since then there have been significant changes in the devolved regulatory regimes under which housing associations operate. In addition, changes in the operating environment for housing associations means that new business risks have arisen and those identified in the previous revision of PN14, while mostly still relevant, have changed in their relative significance

Our revisions were made to help facilitate high-quality audit and have been made with advice and assistance from staff of:

- **The Housing Regulation Branch (Department for Communities)** – Northern Ireland
- **The Regulator of Social Housing** – England
- **The Welsh Government's Housing Division** – Wales
- **The Scottish Housing Regulator** - Scotland

In November 2020 the FRC issued a public consultation on the proposal to revise PN14. The key revisions proposed are shown in the following table.

Key Revision	Explanation
Revision of sections relating to the devolved regulatory regimes	<p>Since the last revision of PN14 in 2014 there have been significant changes in the devolved regulatory regimes, which the revised PN14 provides an introduction to.</p> <p>Changes in the relevant regulations are reasonably frequent, meaning that detailed descriptions in a practice note age quickly and risk incorrect information being used by auditors.</p> <p>As such, to aid in usability and to ensure that the information available is current, we have taken an approach of including a brief introduction to each of the devolved regulatory regimes, and linked to further detail on the regulator’s website, which is updated for changes much more frequently than a practice note.</p>
Updating of key business risks	<p>The key business risks in the current PN14 are largely still valid but their relative significance has changed. We have amended the risks, combining them where they relate to similar issues and have included new material relating to housing stock value, leasing and the impact of health, safety and fire regulations.</p>
Updating of ISA (UK) specific guidance with new sections on ISA (UK) 570 and ISA (UK) 720	<p>We have clarified our guidance to auditors in applying the ISAs (UK) to the audit of housing associations, updating to reflect changes made to ISAs (UK) since 2014.</p> <p>The following sections have been most substantially revised:</p> <p>ISA (UK) 250 Section A Consideration of Laws and Regulations in an Audit of Financial Statements – Given the significant changes in regulation, we have updated material on the relevant laws and regulations.</p> <p>ISA (UK) 402 Audit Considerations Relating to an Entity Using a Service Organisation - We have included new material on the use of service organisations given housing associations often make significant use of them, including for the provision of repair services.</p> <p>ISA (UK) 570 Going Concern – Given the substantial revisions to ISA (UK) 570 in September 2019, we have significantly revised this section, including additional material on how the business risks identified may indicate events or conditions exist which cast doubt on the entity’s ability to continue as a going concern.</p> <p>ISA (UK) 720 Auditor’s responsibilities relating to other information – We have included new material relating to ISA (UK) 720. Housing associations may be incorporated under a number of different pieces of legislation, depending on their legal form, each of which may have different requirements regarding the other information which must be prepared.</p>

The FRC’s consultation received four formal responses, which although a small number, was expected given the significant involvement of the key housing association stakeholders in the original preparation of the PN14 Exposure Draft. In addition to the written responses, we reached out to the ICAEW’s Social Housing Committee and the Housing SORP Working Group for comment.

In drafting PN14 the FRC convened a working party including auditors with specialism in housing associations, members of housing associations' Boards and FRC staff from the Audit Quality Review (AQR) team, enabling us to draw on a wide range of experience and expertise in revising this practice note. Finally, the working party to revise PN 14 included the four regulators of the devolved housing associations' regimes in the UK who were able to provide significant insight and assistance in preparing the PN14 Exposure Draft.

Consultation Feedback and FRC Responses

In general, all respondents welcomed the FRC in revising PN14 in order to address legislative and regulatory updates, to reflect the current complexities faced by housing associations and to ensure that guidance on the application of the ISAs is specific to the audit of a housing association and avoids simply repeating material from the ISAs.

A summary of the responses received to the specific questions asked in the consultation, and the FRC's response, are set out below.

Q1: Do you agree with the approach taken to providing information on the devolved regulatory regimes, linking to the regulators' websites to allow for more frequent updates, is reasonable?

Summary of Feedback and FRC Responses

All respondents agreed that providing links to documents published by the devolved regulatory regimes rather than including detailed regulatory information with PN14 was a sensible approach. Respondents felt this provided auditors with important regulatory material, but in a way which ensured the information was up-to date and made sure PN14 was appropriately balanced between providing a summary of regulatory information and tailored guidance on sector-specific risks and application of the ISAs.

Respondents suggested that PN14 should also include links to:

- sector risk profiles for each of the devolved regulatory regimes
- regulatory judgements for each of the devolved regulatory regimes

The FRC agrees that providing additional links such as those highlighted above would be beneficial so have made small changes to the Regulation of Housing Associations", Sections 23 to 46 in order to link though to the sector specific risk profiles produced by each of the devolved regulatory regimes, and where available, to recent regulatory judgements.

We have also made arrangements for the housing regulators in each of the devolved regimes to inform the FRC should any links change, or should their regulator approach significantly change, so that this material can be updated in a timely manner.

Q2: Do you agree with the revised and updated business risks? Do you believe there are any additional risks that the FRC should consider?

Summary of Feedback and FRC Responses

Responses to Q2 were generally favourable, with respondents agreeing with the re-ordering of the business risks to reflect the current operating conditions that housing associations face. Respondents also agreed with the inclusion of new risks relating to “Exposure To Significant Economic Disruption” and “Increasing Diversification into Non-Social Housing Activities” but made suggestions as to how those risks could be improved to better provide guidance to auditors.

Three quarters of respondents believed that the material on the risk of “Exposure to significant economic disruption, including fluctuations in the housing market”, paragraphs 69-74, should be revised to highlight that fluctuations in the housing market are likely to have a more significant effect on those housing associations who develop large numbers of properties for sale, either for shared ownership or outright sale, as significant decreases in the value of these properties would be much more onerous for these Associations. The FRC agrees this is a sensible addition to PN14, and we have amended this section to reflect the additional business risk faced by associations with significant build to sell portfolios.

Building on this, one respondent highlighted that where reference is made to fluctuation in the value of properties used as debt security (paragraph 70), additional information should be provided on those properties which are valued using the “Existing Use Value for Social Housing” method, as they may be subject to less volatility in value than properties valued with other market-based methods. The FRC agrees this is useful information for auditors and we have added material to paragraph 71 to explain this within PN14.

Half of respondents believed that a risk relating to defined benefit pension schemes should be included, highlighting that some housing associations have such schemes which are in significant deficit. This was discussed amongst the working party members when drafting the Exposure Draft and it was noted that whilst many housing associations do have pension deficits, the potential concerns as a result of this were not unique to housing associations but shared with other entities which also have substantial defined benefit pension schemes. As a result, given the desire to limit material in PN14 to those risks that are either unique to housing associations or disproportionately affect them, we have concluded that a risk associated with defined benefit pension schemes should not be included within PN14.

Based on the feedback received we have also updated the risk relating to “Inappropriate Board Composition”, paragraphs 81- 83, in order to reflect the wider risk that housing associations may be detrimentally affected by poor governance structures beyond just inappropriate board composition. This includes, for example, where a housing association has failed to design and implement an effective system of internal controls.

Finally, half of respondents suggested that the risk “Diversification into non-social housing activities”, paragraphs 75-80 should be updated to reflect the potential reputation risk to a housing association should non-social housing activities be inappropriately delivered. Significant reputation damage may lead to financial difficult for a housing association if it is unable to access grants and funding as a result. The FRC agrees that this is a relevant addition to PN14, so we have included additional material at paragraph 76.

Q3: Do you agree that the revised and updated guidance relating to the ISAs (UK), particularly the new material relating to ISAs' (UK) 402, 570 and 720, supports auditors in applying the ISAs (UK) to the audit of housing associations?

Summary of Feedback and FRC Responses

All respondents agreed with PN14 having additional material included in relation to ISAs (UK) 402, 570 and 720 and agreed that this material would be beneficial to auditors undertaking the audit of housing associations financial statements. Respondents also suggested a number of potential revisions to these sections, and others, which we have summarised below.

ISA (UK) 402 Audit Considerations Relating to an Entity Using a Service Organisation

Respondents generally agreed that including material to assist auditors in addressing housing associations oftentimes significant reliance upon service organisations was helpful.

One respondent highlighted that it would be beneficial for PN14 to include additional detail on the nature of the repairs and maintenance services potentially provided by service organisations and the significance of those services, particularly how their use may impact on a housing associations internal controls system. The FRC agrees this is a sensible addition and so we have added additional detail at paragraph 134 to provide more information on housing associations use of service organisations.

In addition, half of respondents suggested that paragraph 135 be re-worded to make clear that the potential controls listed are examples only, and that the phrase "including but not limited to" inferred a minimum standard that is not described in the base ISA. We have updated the wording in paragraph 135 to clarify this.

ISA (UK) 570 (revised September 2019) Going Concern

As above, all respondents agreed that the additional material relating to ISA (UK) 570, including updates to reflect changes made to the standard in September 2019 was useful to auditors.

Half of respondents suggested that paragraph 161, which states that the latest viability information available for a housing association, published by the regulator, is likely to inform the auditors consideration of going concern, should be expanded to make clear that whilst the viability assessments will be a part of the evidence collected around going concern, additional supporting evidence will also be sought regarding the key assumptions and other data used in making assessments. As such, we have amended this paragraph to reflect the likely work effort of auditors when assessing the going concern status of a housing association.

Additionally, we received feedback that whilst the auditor's responsibilities are clear in this section, it would be beneficial to include a brief statement of managements responsibilities in relation to going concern, which we have added to paragraph 165.

One respondent also noted that paragraph 172, which provides guidance on obtaining confirmation from third parties on the availability of future funds, focuses mainly on the availability of grants. It was noted that this is helpful, but it was suggested material could be included on the continued availability of other fund sources, such as commercial loans. The FRC agrees this is a sensible addition and has added additional commentary to paragraph 172 to address this.

Finally, one respondent noted that paragraph 170, which provides a list of factors which may indicate a potential going concern problem at a housing association, is expanded on in paragraph 171 onwards but only for two factors, "Increasing complexity of health and safety regulations" and "Exposure to significant economic disruption, including fluctuations in the housing market" and questioned if it would be beneficial to expand on other factors listed in paragraph 170. We focused on the two factors above as discussions at the working party indicated these were the most pressing concerns from a housing association perspective currently and we wish to avoid providing detail on every potential factor so as to ensure PN14 is as clear and useable as possible.

ISA (UK) 720 (revised November 2019): The Auditor's Responsibilities Relating to Other Information

As with ISA (UK) 402 and ISA (UK) 570, all respondents supported the inclusion of additional material relating to ISA (UK) 720 and welcomed links through to both the FRC's Bulletin of Illustrative Auditors reports and PN 11 (Revised) The Audit of Charities in the United Kingdom.

Based on the feedback received, we have updated paragraph 182 to make reference to one of the key pieces of other information generally included in housing association accounts, which is Value for Money (VFM) reporting. VFM reports, or similar requirements, are necessary in all the devolved regimes, and usually require both narrative reporting on how a housing association is achieving value for money but also the presentation of specific calculations and metrics.

Other ISAs

ISA (UK) 240 (updated January 2020) The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Three quarters of respondents recommended that paragraph 90 should be expanded to include some additional examples of potential frauds within housing associations, specifically relating to the risk of fraud occurring around property sales (under value sales to connected individuals) and the potential risk of rent fraud (collusion between asset and housing teams to let properties to third parties and collect rent fraudulently). The FRC agrees that these would be sensible additions to PN 14 and as such we have expanded paragraph 90 to include these items.

Additionally, we have revised the wording in paragraph 89 to also include reference to internal factors that an auditor should be aware of when assessing the likelihood of material misstatement due to fraud.

ISA (UK) 315 (revised July 2020): Identifying and Assessing the Risks of Material Misstatement

Based on feedback received, we have updated the list of accounting policies relevant for a housing association, at paragraph 116, to include grant accounting. Grants are often a significant balance for housing associations given the level of grant funding the sector receives, and both FRS 102 and the SORP have very specific accounting requirements subject to significant judgements.

ISA (UK) 320 (revised June 2016) Materiality in Planning and Performing an Audit

Based on the feedback received, we have updated the material on ISA (UK) 320 to include discussion within paragraph 128 that indicates a methodology which uses a single materiality per provider is also used by some firms and may also be an appropriate approach to determining materiality.

Additionally, we have included new material at paragraph 129 which addresses some of the specific qualitative considerations regarding materiality which are relevant to the housing sector. For example, certain disclosures may be subject to greater scrutiny by housing regulators, and auditors may subsequently determine, in line with ISA (UK) 320, paragraph 10, that certain classes of transactions, account balances and disclosures should be audited to a reduced materiality level when compared to the level of materiality determined for the financial statements as a whole.

Other Changes

In addition to the above, we have also revised some sections which address the accounting requirements of both FRS 102 and the Housing SORP to better reflect current requirements and highlight accounting treatments that are subject to greater levels of judgment by management.

Impact Assessment

Practice notes provide additional guidance on applying the ISAs (UK) to the special considerations that arise in certain sectors and do not create additional requirements or obligations for auditors.

We believe that the revisions to PN14 are proportionate and reflect the key risks that auditors may wish to consider when engaged to audit a housing association. We do not believe that the revised guidance included in PN14 will increase auditors' work effort; it provides clear guidance in applying the ISAs (UK) to the audit of a housing association.

Financial Reporting Council
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Appendix

Respondents to the consultation on the proposed revision of PN14

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