Financial Reporting Council

Practice Note 14

The Audit of Housing Associations in the United Kingdom

(Revised March 2021)

Contents

The Audit of Housing Associations in the United Kingdom

1. Practice Note (PN) 14 provides sector-specific guidance on applying International Standards on Auditing (UK) (ISAs (UK)) to the audit of housing associations, which are sometimes also referred to as Registered Social Landlords (RSLs). Housing associations are private sector bodies that generally provide affordable housing at below-market-rate rents and may also offer individuals who might otherwise struggle to purchase their homes, an opportunity to do so.

2. Housing associations operate under devolved regulatory regimes and there has been significant change in all jurisdictions in recent years. This practice note contains links to the websites of each of the UK's regulators as well as a summary of information relevant to auditors. It is not, however, intended to provide detailed advice to auditors on regulatory matters.

3. This practice note consists of the following principal sections:

   - Background information about the sector, providing context for the other three sections including a brief discussion on the devolved regulatory regimes.
   - A description of the business risks that could have an adverse effect on a housing association achieving its objectives or successfully executing its strategies, and which may give rise to a risk of material misstatement in its financial statements; and
   - A discussion of audit risks, primarily arising from business risks, which an auditor will need to consider. This section is written in the context of special considerations relating to the audit of housing associations. It is not the intention of the practice note to provide step-by-step guidance to the audit of housing associations; hence no material is included where there are no special considerations arising from an ISA (UK).

4. This practice note has been prepared with advice and assistance from staff of the:

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

5. This practice note is based on the legislation and regulations that were in effect as at February 2021. This practice note does not constitute general guidance given by the above regulators or industry guidance, neither is it intended to be an exhaustive list of all the obligations that housing associations, and their auditors, may have with respect to the relevant devolved regulatory regimes. Changes in government or in policy may lead to developments in housing association regulation, and auditors should remain alert to changes in the environment within which housing associations operate.

Background to Housing Associations[1]

What are Housing Associations?

6. Until relatively recently, housing associations were exclusively not-for-profit bodies. However, some housing associations are now permitted to operate on a for-profit basis. The audit of for-profit providers is outside the scope of this practice note.

7. Rental receipts from general needs housing make up approximately 80% of the aggregate income of housing associations. The stability of this income is underpinned by housing benefits provided by the state (included within Universal Credit in many areas of the UK), which contributes around 70% of rents from general needs housing.

8. A number of government schemes have been developed to encourage either full or part purchase (known as shared ownership) of homes for owner occupation. Shared ownership has been offered by housing associations for many years, with over 200,000 such homes currently in existence. Shared ownership involves a buyer purchasing 25% and 75% of a property from a housing association (although this percentage may be as high as 90% in Northern Ireland) with the association retaining the residual share and renting it to the purchaser at a subsidised rent. Purchases often have the option to increase their share during their time in the property via a process known as 'staircasing', and in most cases can staircase all the way to 100%. Legislation changes have, however, ended some right-to-buy schemes: in Wales from January 2019 and Scotland from July 2016.

9. Housing associations are regulated by the following regulators:

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

10. Housing associations are independent organisations in the private sector and their legal status will depend on the legislation under which they are incorporated:

    - A large majority are now Co-Operative and Community Benefit Societies registered with the Financial Conduct Authority (FCA) under the Co-operative and Community Benefit Societies Act 2014. Prior to this, the majority were Industrial and Provident Societies under the Industrial and Provident Societies Act 1965.
    - Some housing associations are established as companies limited by guarantee (this is common in the case of housing associations that were established to receive a transfer of former local authority housing stock).
    - Some housing associations are registered charities, although this depends to some degree on the devolved regime; in Scotland, for example, most housing associations are charities.

Magnitude and Diversity of the Housing Association Sector

11. From the late 1980s onwards, local authorities have been restricted in their ability to build new homes and, since that time, the housing association sector has grown steadily both through building new homes and through the transfer to housing associations of existing homes from local authorities.

[1] Information and statistics quoted as background information were current as at October 2020. Readers are cautioned that this information may have changed since publication of the practice note.

12. UK housing associations provide more than five million homes, around a sixth of all properties, and operate a number of different business models ranging from small local providers of social rented homes to large diversified organisations participating in both social and commercial activities. Examples of commercial activities undertaken by a number of housing associations are development of properties for private rental or sale and the operation of care homes for the sick and the elderly.

Financing of Housing Associations

13. At the time of writing, housing associations had attracted in excess of £80 billion in bank and capital market finance. As housing association finance is outside the public income and expenditure regime, its borrowings do not contribute to public debt and are regarded as private finance.

14. Much of the finance for housing associations has been provided by a relatively small number of UK banks and building societies. Historically, housing associations have frequently sought, and obtained, 30-year maturities on the monies they borrow. In the last decade, however, increasingly stringent prudential requirements have meant banks have not been able to offer these more favourable terms.

15. In response to this concern, housing associations are using a wider range of funding sources including: the capital markets through the issuance of bonds; private placements; and direct investment by pension companies.

16. Potential investors in bonds have historically placed strong reliance on the security that they derive from the fact that housing benefit is paid by the Government directly to the housing association. This reduces the risk of rent arrears and the cost of collection. The security was historically facilitated by the tenant waiving their rights to receive benefit personally at the time they first claimed it.

17. However, under the Welfare Reform Act 2012 the payment of Universal Credit replaces housing benefit and is intended to replicate, as far as possible, how people would be paid if they were in work. The Act, therefore, enables housing costs within Universal Credit to be paid to the individual in the social rented sector, rather than directly to the housing association. It is still possible for housing costs to be paid directly to the housing association in what is referred to as a 'managed payment', although this is now a more complex process.

18. The Government also recognises the importance of stable income from rent for social landlords to support the delivery of new homes. Universal Credit, therefore, contains some safeguards to help protect landlords' income.

Governance at Housing Associations

19. Housing associations often have governance structures that do not involve the executive management being members of the main Board. Rather, the Board consists of a number of non-executives who are collectively 'those charged with governance'. However, in some cases they also co-opt members of their executive management team including the Chief Executive and Finance Director as board members. Many housing associations have tenant board members, and Stock Transfer Associations[2] are typically required to have tenant board representation as well as board members drawn from local authorities whose stock has been acquired.

20. Although the proportion of housing associations paying their board members has increased significantly, particularly among larger housing associations, some boards still do not pay their members.

[2] A Stock Transfer Housing Association is one that has received a transfer of housing stock from a local council. Stock transfer was established in order to increase investment in social housing. This was possible because housing associations had greater resources than local councils to invest in housing, community improvements and services.

Accounting by Housing Associations

21. The applicable accounting framework for most housing associations is Financial Reporting Standard (FRS) 102, although a common element of the regulation of each of the housing regulators is the establishment of regulatory accounting requirements. Each of the four regulators has accounting requirements that require housing associations, among other things, to state in the notes to the accounts the basis and standards under which the accounts have been prepared. Particulars of, and reasons for, any material departures from those are generally also required disclosure.

22. As noted above, the applicable financial reporting framework for housing associations is FRS 102, but further guidance that may be required to enable particular sectors to implement accounting standards effectively is issued in the form of a statement of recommended practice (SORP), by bodies recognised for the purpose by the FRC. The SORP relating to housing associations is regarded as being the applicable statement referred to in the various regulatory accounting requirements.

Regulation of Housing Associations

23. The regulation of housing associations is a devolved responsibility, meaning different regulatory regimes are applied in England, Northern Ireland, Scotland and Wales.

24. This practice note does not contain a detailed overview of each of the devolved regulatory regimes. Instead, a brief description is included below, with links to further information on each of the regimes held on the relevant regulator's website.

25. In addition to regulation relating to their activities as housing associations, some associations may be subject to additional regulation dependant on the range of services provided. For example, some associations may be regulated by the Care Quality Commission (CQC) where they provide health and social care services. Housing associations that build homes for rental or sale are subject to building regulations within the UK.

Northern Ireland

26. The Department for Communities (DfC) is the regulatory authority for registered housing associations in Northern Ireland. Advice notes on the regulatory framework and other topics can be found at Housing Regulation Advice Notes.[3]

27. Housing associations are required to demonstrate compliance with standards in the following areas:

- **Governance:** encompasses robust risk management processes that support the business and allows them to be fully innovative while ensuring efficient use of public funds;
- **Financial:** addresses the mechanisms in place to protect assets and public funds, financial planning and assumptions, and risk management; and
- **Consumer:** focuses on tenants, considers tenant involvement, complaints, services, and understands tenants' needs.

28. The Housing Association Guide is one of the key management tools employed by the DfC to deliver its regulatory responsibilities. It sets out the Department's guidelines for housing associations, requiring robust policy and procedural standards across all associations and equitable quality service provision for social housing tenants. It also contains the rules and procedures that associations must comply with in order to meet the conditions for receipt of capital grant from the Northern Ireland Housing Executive (Development Programme Group).

29. The current regulatory judgements for housing associations are published at DfC Housing Regulation.

30. The DfC sets out in its Social Housing Sector Risk Profile the common risks likely to apply to the provision of social housing in Northern Ireland.

Wales

31. Welsh housing associations are regulated by Welsh Ministers exercising their powers under the Housing Act 1996. This includes the power to set standards of performance relating to the provision of housing and their governance and financial management. Regulation is carried out on behalf of the Ministers by a regulation team within the Housing and Regulation Directorate of Welsh Government.

32. A copy of the regulatory framework can be found on the Welsh Government website via the following link; Regulatory Framework in Wales.

[3] Text highlighted in blue and underlined represents a hyperlink to the relevant webpage.

33. Key elements of the framework are:

- Tenants remain at the heart of regulation, with improved accountability and transparency to tenants and other stakeholders;
- The underpinning principles of proportionality, transparency and openness, consistency and promotion of learning and development, are unchanged; and
- The approach to regulation continues to be founded on co-regulation.

34. All associations are expected to carry out regular self-assessment that evaluates their performance. Detailed requirements and expectations are set out in Welsh Government advice and guidance which you can find here: requirements and expectations.

35. Housing associations in Wales are subject to continuous assessment and receive a published judgement at least annually. The judgement jointly considers the RSL's governance and service delivery alongside its financial viability and its capacity to improve should it not be currently meeting one or more of the standards. The published judgement only references areas of performance and risk that are not being appropriately managed at the time of publication. Recent regulatory judgements can be found here.

36. The Welsh Government sets out in its Sector Risk Overview the common risks likely to apply to the provision of social housing in Wales.

England

37. The Regulator of Social Housing (RSH) is the regulator for registered providers of social housing in England, which became independent from the Homes and Community Agency (HCA) on 1 October 2018. The objectives of the RSH are set out in the Housing and Regeneration Act 2008. These include protecting social housing assets and ensuring providers are financially viable and properly governed to maintain confidence of lenders to invest in the sector. In addition, the RSH ensures tenants are protected and that they are getting value for money on service delivery. The RSH achieves this through its Regulatory Framework.

38. The framework includes three economic standards that are of relevance to auditors of housing associations: Governance and financial viability; Value for Money; and Rent.

39. The regulator publishes a number of documents about the English housing sector, in particular, its assessment of individual providers with more than 1,000 homes regarding their compliance with the economic standards. This includes their ability to meet financial obligations, their approach to value for money and their governance.

40. Regulatory judgements are one of the key ways in which the regulator communicates its views about the sector and individual housing associations to the wider world. In particular, these judgements contain the regulator's view of whether the association meets its governance and financial viability standard. There are four financial viability grades and four governance grades. The first two of these grades confirm that the housing association is meeting the RSH's expectations, while the last two indicate a failure to meet its standards. The viability grades are likely to be of relevance to auditors. Further information can be found in the publication, Regulating the Standards.

41. The RSH sets out in its Sector Risk Profile the common risks likely to apply to the provision of social housing in England.

Scotland

42. The Scottish Housing Regulator (SHR), established by Part 1 of The Housing (Scotland) Act 2010, is a non-ministerial department responsible for regulating social housing in Scotland.

43. The SHR's obligations under the Act are that regulation is proportionate, consistent, accountable, transparent and targeted only where needed. The SHR assesses risk in housing associations to determine what assurance is required from them and what they may need to improve. Risk-based regulation enables the SHR to focus on the key risks to tenants, prioritise resources and plan how to engage with RSLs through further scrutiny, engagement and statutory intervention, where necessary.

44. The SHR has issued a suite of statutory guidance to assist RSLs to understand their responsibilities and what they need to do. Accounting and auditor specific guidance includes (but is not limited to):

- the statutory requirement to submit audited annual accounts within six months of the financial year end;
- additional disclosure requirements in the notes to the audited annual accounts;
- the statutory duty on auditors to report events of material significance.

45. All housing associations must prepare and publish an Annual Assurance Statement (AAS), to confirm to their tenants and the SHR that they comply with the relevant requirements of the regulatory framework. Where an RSL does not fully comply, it should set out in the AAS how and when it will make the necessary improvements to ensure compliance.

46. The SHR sets out in its Summary of Risks the common risks likely to apply to the provision of social housing in Scotland.

Business Risks Relevant to Housing Associations

47. Housing associations need to have in place appropriate policies and strategies to deal with the business risks[4] that emerge for that entity. It is important that the auditor develops an understanding of the way in which the housing association seeks to address these risks, and in particular assesses whether there are ongoing processes embedded within the association's operations that allow them to monitor the effective application of policies and activities relating to risk management.

48. The following discussion of business risks is intended only to guide auditors as to the relevant risks that they might consider with respect to housing associations, but it is not a definitive list. As each association is unique, auditors consider whether there are other relevant business risks that may be applicable.

Business Risks Considered

49. The following list sets out some of the key business risks that may give rise to a risk of material misstatement:

- Increasing complexity of health and safety regulations;
- Housing associations entering into increasingly complex and risky financing arrangements, including lease arrangements;
- Uncertain receipts from government housing benefit creating a greater risk of bad debts and property voids;
- Exposure to significant economic disruption, including fluctuations in the housing market;
- Diversification into non-social-housing activities;
- Increasing reliance upon service organisations for the provision of business-critical services;
- Inappropriate governance arrangements, including Boards that may not have appropriate skills and experience.

Increasing Complexity of Health and Safety Regulations

50. A primary issue facing housing associations is balancing their spending between building new homes and improving their existing stock. The future of grant funding is uncertain and any reduction in grants for new-build homes may result in housing associations reducing their investment in improving existing stock. However, as housing associations are required by the regulator to maintain the standard of their existing stock, the regulator will act if a housing association is considered to be investing in new homes at the expense of current tenants.

51. This issue has become particularly pertinent after the fire at Grenfell Tower in 2017. Many housing associations have undertaken the most complete review of their compliance with health and safety standards in some time, identifying deficits that may be costly to rectify and which will need to be addressed in order to ensure compliance with the relevant health and safety standards. Accounting for significant rectification costs may lead to material misstatement owing to the complexity in both estimating the costs themselves and determining any potential cost recovery from government schemes. Additionally, unrecorded liabilities are a risk where failure to rectify costs could lead to potential regulatory action and fines.

[4] As defined in ISA (UK) 315,4 (b)

Housing Associations Entering into Increasingly Complex and Risky Financing Arrangements

52. Until the financial crisis of 2008, banks had been willing to lend to housing associations for long terms and to charge relatively low rates of interest. A key factor in obtaining such lending was the ability of the housing association to receive its tenants' housing benefit directly from the Government (rather than via the tenant), creating a more stable, long-term income stream.

53. The introduction of Universal Credit disrupts this, with tenants now being directly responsible for the paying of rent. Traditional lenders have increasingly looked to lend for a shorter term and are charging higher margins on both new and existing debt where they have an opportunity to re-price. This continues to be the case, with banks still typically looking to lend for five or ten-year terms rather than 30-year terms, though some banks may now offer longer terms dependant on the housing association's circumstances and the quality of their housing stock.

54. Housing associations have increasingly been looking to the wholesale bond markets to satisfy their financing needs. Larger housing associations often access the capital markets directly using a particular facilitator whereas smaller housing associations are able to access the capital markets through aggregating bodies such as the Housing Finance Corporation, which is able to 'lend on' funds to housing associations on the same terms as it is able to borrow.

55. Although wholesale bonds are usually relatively straightforward financial instruments, the terms and conditions associated with an issuance may be complicated and need to be well understood by management, the Board of the housing association and the auditor. Bonds, for example, may be issued in overseas markets in non-sterling currencies, giving rise to foreign currency risk.

56. Housing associations have increasingly been entering into interest rate swaps, typically to convert variable rate loans into fixed rate loans to enable the housing association to build some certainty into its business plan. Although the swaps are usually undertaken with a financial institution there is a growing incidence of swaps being undertaken between housing associations. Such swaps are typically less costly than swaps involving a financial institution. However, they may be riskier as they rely on the counterparty housing association continuing in business during the period in which the swap is effective.

57. When a housing association issues a bond, it may be listed on the Official List thus giving rise to the obligations that arise from being listed. This would also result in the housing association falling within the definition of a Public Interest Entity,[5] having implications for both the housing association and its auditor.

58. Financing may involve complex guarantees and housing associations need to be aware of the implications of guarantees both that they enter into and also of guarantee obligations that they may have acquired when making a business acquisition. In the acquisition of new business interests, the existence of guarantees against loans may not be immediately apparent if appropriate due diligence activities were not undertaken at the time of the business acquisition. Risks associated with guarantees may be particularly acute where a housing association diversifies into non-social-housing activities.

59. In addition, housing associations may face risks relating to historic debt covenants, where changes to accounting policies or one-off large expenditures may potentially lead to breaches.

60. The relative risk of covenant breach often depends on the type of debt, with bank lending often having numerous covenants attached, whereas capital market funding is likely to have fewer covenants attached.

61. As the impact of non-compliance with covenants could be significant for a housing association, there is a potential incentive for the preparers of the financial statements, management of the housing association or the Board to prepare information biased towards meeting those covenants.

[5] FRC Glossary of Terms (Auditing and Ethics) (updated January 2020).

62. Some housing associations, in attempting to fund property acquisitions with a lower initial capital outlay, have increased the number of properties acquired through leasing arrangements. Although this can often be a cheaper means of acquiring new properties, in the long term this can be a more expensive option and may provide less long-term stability.

63. Properties that are held on lease also cannot be used as security against debt, meaning that the available stock of assets against which debt can be secured, should the housing association need to raise additional finance, is reduced. In addition, leasing arrangements can be more complex to account for than fixed assets owned outright or purchased with a bank loan, depending on the specific contractual terms.

64. This may lead to a greater risk of inappropriate accounting and disclosures. Leases often contain specific provisions and contractual arrangements, such as dilapidations, which introduce a significant degree of judgement into the accounting.

65. Housing associations may also participate in schemes developed under the Private Finance Initiative (PFI). Under such schemes, a housing association may, for example, maintain properties without having ownership of the properties and thus will be unable to use these properties as security for raising finance.

Uncertain Receipts from Government Housing Benefit Creating a Greater Risk of Bad Debts and Property Voids

66. The Welfare Reform Act 2012 continues to have an impact on the revenues of housing associations. Among other things, the Act:

- reduces the amount of benefit payable to claimants if they are deemed to have too much space, often owing to a spare bedroom in the property; and
- legislated for Universal Credit, which has seen benefits, including housing benefit, paid to claimants as opposed to landlords directly.

67. These changes potentially adversely affect the cash flows of housing associations through, for example:

- increased arrears;
- the need to introduce new debt collection procedures (including the possible need for additional staff);
- additional legal costs associated with the above issues.

68. Rent increases are typically tied to a price index (generally either the Consumer Price Index (CPI) or the Retail Price Index (RPI)) and are effectively determined by the Government. Low annual increases in retail prices affect housing associations such that rent increases may be smaller than expected; this is especially problematic if costs are rising at a faster rate. This is sometimes referred to as ‘rent capping’, a process that operates in different ways across the different devolved regulatory regimes.

Exposure to Significant Economic Disruption, including Fluctuations in the Housing Market

69. External events that lead to significant economic disruption affect most industries but may have a greater degree of impact on housing associations as they rely on the valuation of property as a base for financing, and often provide services to individuals who may be less able to cope with significant long-term economic disruption.

70. Historically, housing associations have relied on a buoyant property market to secure financing as well as for their own financial security, being able to sell properties to mitigate cash shortages if the need arises.

71. Significant fluctuations in the property market, and uncertainty driven by external factors, may lead to housing associations being unable to realise the level of cash from properties they may once have been able to. The impact on housing associations is likely to be more significant if there are other factors impacting on its financial situation, such as higher costs to rectify safety issues. Fluctuations in the property market may have an impact on

debt covenants that utilise balance sheet metrics, leading to potential penalties or issues acquiring future financing. Some of these factors – whether individually or in aggregate – may lead to a material uncertainty with regards to an entity's going concern. Significant fluctuations in property value are likely to disproportionally affect housing associations with significant build-to-sell portfolios, either outright or through part-ownership schemes. Properties held under the Existing Use Value for Social Housing (EUV-SH) and Market Value subject to Tenancies (MV-T) valuation models are likely to be less sensitive to significant economic disruption than those held under a fair value model.

72. Some housing associations are increasing the number of new homes built through the use of modular housing, homes that are built in a factory environment and then installed on site. Where these properties are used as security, the process is likely to be more administratively complex, with more demanding covenants included.

73. Significant economic downturns may lead to a corresponding reduction in revenues for housing associations, particularly where government action to mitigate the adverse impacts of significant economic disruption leads to reductions in social housing benefits, and an increased risk of bad or doubtful debts. There is also likely to be an increase in non-housing support costs as housing associations try to mitigate impacts on their most vulnerable tenants.

74. In addition, government action to mitigate the adverse impacts of significant economic disruption may lead to fewer grants being made to housing associations both to build new homes and to maintain existing housing stocks.

Diversification into Non-social Housing Activities

75. A number of housing associations have diversified into activities other than core social housing activities. Examples of such non-core activities are care and support activities, including providing job search assistance and aiding tenants with other support claims. Housing associations may provide these services directly to tenants or may provide these services in conjunction with another provider, potentially further increasing their reliance on service organisations.

76. Such activities may expose the housing association to additional risks, with a key consideration being heightened reputational risk resulting from the vulnerability of the tenants being cared for.

77. Care and support activities can be contracted or subcontracted to or from partner organisations. This may increase the inherent risk as the housing association is dependent on the performance of others. The level of additional risk also depends on if the care is delivered to individuals in their own homes, or if the housing association is running a dedicated care facility.

78. If performance targets are not met in line with funding agreements, it can have a direct impact on the amounts of revenue that can be recognised and result in returns being less than expected. Ultimately this can affect the financial viability of the non-social-housing activities and the association.

79. The outsourcing of repair works to service providers is significant, with many housing associations relying on these providers for a large percentage of repair works. While this can be less burdensome in the short term for associations, it may lead to increased risk if the third-party relationship is challenging to manage, if that third party is not able to complete work on time, if they complete work that is sub-standard, or if the provider experiences financial or operating difficulty.

80. Some councils may pay rental income directly to housing associations for certain tenants. Often these payments are made in bulk with a breakdown only being provided later and, depending on the nature of the relationship between the housing association and the council, may also include the journal entries to be posted in the housing associations' accounts. Some housing associations are very reliant on councils to provide this information, creating a relationship between the two that may be similar to that which a housing association has with one of the other service providers described above.

Inappropriate Governance Arrangements, including Boards that May Not Have Appropriate Skills and Experience

81. In line with many other types of 'public benefit entity'[6] organisations, housing associations often have governance structures that do not involve members of the executive management team (including the finance director) being members of the Board. Instead, there are a number of non-executive members who are collectively 'those charged with governance'.

82. As a result, there is a risk that governance at housing associations is not conducted in a unified fashion. For example, the Board and executive management may not communicate and share ideas effectively. This may be challenging, for smaller housing associations, while larger associations may make significant progress in recruiting a more diverse range of skilled board members.

83. In addition, other changes to a housing association's operations may mean that existing governance structures could become inappropriate, for example where the housing association participates in a merger and one of the merger entities has a less stringent approach to governance than the other, or where there is significant diversification into non-social-housing activities that require different governance processes to be effectively delivered.

[6] FRS 102, Glossary. A public benefit entity is: 'An entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members.'

Audit Risks Relevant to Housing Associations

84. Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.[7] Audit risk is a function of both the risk of material misstatement and the risk that the procedures performed by the auditor will not detect a misstatement, known as detection risk. Examples of business risks that may result in a risk of material misstatement are discussed in paragraphs 47 to 83 above.

85. The discussion in the following paragraphs is to draw attention to aspects of ISAs (UK) that may be particularly applicable to audit risk in the context of housing associations. Where a specific ISA (UK) is not discussed this is not because its requirements are not relevant to the audit of housing associations, but because there are no significant additional considerations arising as a result of the entity being a housing association.

86. The ISAs (UK) discussed in the following paragraphs are:

- 240 (revised June 2016) (updated January 2020): The auditor’s responsibilities relating to fraud in an audit of financial statements
- 250 Section A (revised November 2019): Consideration of laws and regulations in an audit of financial statements
- 250 Section B (revised November 2019): The auditor’s right and duty to report to regulators in the financial sector
- 260 (revised November 2019) (updated January 2020): Communication with those charged with governance
- 315 (revised July 2020): Identifying and assessing the risk of material misstatement
- 320 (revised June 2016): Materiality in planning and performing an audit
- 402: Audit considerations relating to an entity using a service organisation
- 520 Analytical procedures
- 540 (revised December 2018): Auditing accounting estimates and related disclosures
- 570 (revised September 2019): Going concern
- 720 (revised November 2019): The auditor’s responsibilities relating to other information

[7] FRC Glossary of Terms (Auditing and Ethics) (updated Jan 2020).

ISA (UK) 240 (Revised May 2021): The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

87. The following guidance provided in relation to ISA (UK) 240 is relevant to the May 2021 version, effective for periods commencing on or after 15 December 2021. Although the guidance in this section is also relevant when conducting audits in line with the previous version of ISA (UK) 240, such auditors should consider modifying the guidance below where necessary. The key revisions provide increased clarity as to the auditor's obligations together with enhancements to the requirements for the identification and assessment of risk of material misstatement due to fraud and the procedures to respond to those risks.

88. Initially, fraudulent financial reporting involving intentional misstatements may appear less likely than in some commercial entities owing to the absence of trading in shares or significant management bonus arrangements.

89. However, there are a number of other external and internal factors that may motivate the management of housing associations to present a biased financial picture. For example, housing associations may have significant borrowings with stringent covenant terms (often interest cover and gearing covenants).

90. With respect to misappropriation, areas where the Board might, where relevant, be expected to introduce strong internal controls to avoid the occurrence of misappropriation or error include:

- Purchasing (for development and maintenance) including controls that would assist in identifying potential sales to connected individuals at under value;
- Major fund flows (for example the drawdown and repayment of loans and grants);
- Recognition of development or maintenance expenditure in the correct period;
- The potential risk of rent fraud arising as a result of collusion between the asset and housing teams to record properties as tenanted and then sublet for personal gain.

91. When housing associations diversify into the provision of non-housing services, their business model and the controls required to mitigate the risk of fraud may become more complex. Controlling the activities of the housing association effectively may become more difficult, which may lead to an increased level of fraud risk. Auditors may wish to consider how the control environment at the housing association has evolved to respond to these diversified activities.

92. The increasing use of service organisations may also lead to an increased fraud risk owing to a lack of direct control over the operations of a service organisation. Auditors may wish to consider how the housing association has responded to this and developed appropriate controls. This is discussed in more detail in the section on ISA (UK) 402 below.

93. The auditor considers, in responding to the threat of misstatement by fraud, the following:

- How they might obtain a thorough understanding of the nature of the entity's diversifying business model;
- Discussing observations with control functions such as risk, legal, compliance and internal audit where they exist; and
- Developing an understanding of how the entity controls its use of service organisations.

ISA (UK) 250 Section A (Revised November 2019): Consideration of Laws and Regulations in an Audit of Financial Statements

94. ISA (UK) 250 Section A requires the auditor to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements. Determination of which laws and regulations have such a direct effect requires consideration of its governing document, the activities it undertakes and those laws and regulations specifically applicable to those activities.

95. Laws and regulations are likely to have a direct effect on the determination of material amounts and disclosures in the financial statement. There is a broad range of laws and regulations that are potentially applicable, including but not restricted to:

- The applicable devolved regulatory regime relating to the provision of social housing;
- Building and fire safety regulations, including the Housing Act 2004 (Housing Health and Safety Rating System) and the Regulatory Reform (Fire Safety) Order 2005;
- The requirements of the Care Standards Act 2000 for housing associations providing residential care;
- The applicable developed regulatory regime if the housing association is registered as a charity.

96. Breaches of relevant laws and regulations are likely to be of greater consequence to the housing association where they lead to intervention by the regulatory body, the loss of necessary approvals and licences, or result in significant fines.

97. The social housing sector includes a number of diverse activities; hence the requirements of laws and regulations that have a direct effect on the determination of material amounts and disclosures in the financial statements are likely to be derived from the activities undertaken as well as arising from registration with the regulatory body. Significant breaches of the Care Standards Act 2000, for example, can result in loss of registration and hence the ability to undertake particular activities. Similar legislative requirements can affect social housing operations in different parts of the sector and in different parts of the United Kingdom

98. Housing associations that have charitable status have significant direct tax exemptions in relation to income and chargeable gains. Auditors need to have an understanding of these exemptions and concessions in order to determine if there are any activities that may be incompatible with chartable status. Similarly, auditors need to have an understanding of other tax legislation, such as VAT, as non-compliance or errors could have adverse financial consequences for the housing association.

Money Laundering

99. Given the significant cash flows involved in the purchase and development of land, and in particular the fact that some land deals are undertaken at below-market value, auditors need to be aware of the potential for money laundering to occur. For additional guidance on how auditors respond to potential money laundering and for a detailed overview of money laundering, terrorist financing and proceeds of crime litigation in the UK, please see the Appendix to ISA (UK) 250 Section A.

100. Auditors in the UK have reporting obligations under anti-money-laundering legislation to report knowledge or suspicion of money-laundering offences, including those arising from fraud and thefts, to the National Crime Agency (NCA). For auditors of housing associations that are companies, these reporting obligations arise as the auditor falls within the regulated sector in their capacity as an auditor when carrying out statutory audit work

within the meaning of Section 1210 of the Companies Act 2006. For auditors of non-company housing associations, the auditor still needs to consider whether they are required to comply with the anti-money-laundering legislation obligations where the auditor provides a regulated accounting service.

ISA (UK) 250 Section B (Revised November 2019): The Auditor’s Right and Duty to Report to Regulators in the Financial Sector

101. The auditor’s right and duty to report to the regulator of a housing associations varies dependant on the devolved regulatory regime; sections 26–46 include links to the UK housing association regulators’ individual pages on the auditor’s rights and duties.

102. Where the housing association is a charity, the auditor may have additional statutory duties to report to charity regulators in certain circumstances. Practice Note 11: The audit of charities in the United Kingdom[8] contains detailed guidance on when a report may be required.

103. Other than as described in paragraphs 104 and 105, auditors of housing associations usually do not have a statutory duty to report suspected or actual instances of non-compliance with the law or regulations to an appropriate authority.

104. ISA (UK) 250B, however, requires auditors of all entities to consider whether a suspected instance of non-compliance with law and regulations should be reported to the appropriate authority in the public interest. Auditors may wish to take legal advice before making a decision on whether a matter should be reported in the public interest.

105. Where the housing association is a Public Interest Entity, usually because it has listed debts as described in paragraph 57, then the reporting responsibilities applicable to auditors of public interest entities, as described in ISA (UK) 250 Section B, paragraphs 4–6, are applicable.

[8] PN11: The audit of charities in the United Kingdom, paragraphs 230 to 266.

ISA (UK) 260 (Revised June 2016) (updated January 2020): Communication with Those Charged with Governance

106. Those charged with the governance of a housing association typically include the members (executive and non-executive) of the Board of a housing association and the members of an audit committee, where one exists.

107. They have responsibilities at least as onerous as those of full-time paid directors of commercial enterprises in relation to the security of a housing association's income, assets and their proper application.

108. However, unlike many commercial organisations, housing associations often have governance structures that do not include members of the executive team as members of the Board. Instead there are a number of non-executive members who are collectively 'those charged with governance'. This may make communication with those charged with governance more challenging if they are not fully aware of the day-to-day workings of the housing association and the challenges faced.

109. Auditors of housing associations, therefore, need to carefully consider how they determine who 'those charged with governance' are and establish an appropriate communication process with both those individuals and members of the executive team.

110. The objectives of the auditor in communicating with those charged with governance are:

- To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
- To obtain from those charged with governance information relevant to the audit;
- To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and
- To promote effective two-way communication between the auditor and those charged with governance.

111. The business risk that the governance of the housing association may be divided between the Board and the executive management in a disconnected way gives rise to a risk that the auditor of a housing association may not establish appropriate two-way communication channels with the Board, the audit committee (where there is one) and the members of the executive management team.

112. In such circumstances, effective two-way communication is unlikely to be achieved when the auditor communicates with those charged with governance solely by means of formal written reports. In such circumstances, auditors may wish to seek to attend Board meetings, in addition to attending the audit committee, to discuss their reports and, where appropriate, suggest that those charged with governance meet with the auditors without the executive management team being present.

ISA (UK) 315 (Revised July 2020): Identifying and Assessing the Risk of Material Misstatement

113. The following guidance provided in relation to ISA (UK) 315 is relevant to the July 2020 version of the ISA (UK), effective for periods commencing on or after 15 December 2021. Although the guidance in this section is also relevant when conducting audits in line with the previous version of ISA (UK) 315, such auditors should consider modifying the guidance below where necessary.

114. The auditor seeks to understand the overall structure, activities, finances and governance of the housing association. Areas the auditor should consider include:

- The overall governance arrangements of the housing association that support the systems of internal control including the audit committee, risk management and internal audit arrangements;
- The framework for business planning, financial and performance management;
- The main business activities of the housing association and any significant developments since the previous audit, for example development activity, acquisitions or disposals and organic growth areas;
- Cross-subsidies between different business activities of the housing association;
- Component accounting and the need to determine useful economic lives for separate components of fixed assets;
- Policies on capitalisation of internal costs, interest incurred during development and the capital/revenue split of works to existing properties;
- The financing and funding structure that supports the housing association's activities and any significant internal or external developments that may have an impact on the association. Where a housing association makes use of more complex financial arrangement auditors may wish to refer to the FRC's PN 23 – Special Considerations in Auditing Financial Instruments for guidance;
- Changes in accounting treatment of financial statement items following changes in accounting standards.

115. Housing associations may participate in complex projects such as still live schemes developed under the historic PFI. A housing association may, for example, be undertaking the renovation and management of properties or provide other services, such as residential care, over a defined period without having ownership of the properties.

Accounting Policies

116. Accounting policies that are typically relevant to housing associations include:

- Valuation of properties
- Depreciation
- Capitalisation of building costs (including component costs)
- Allocation of overhead costs
- Impairment
- Dilapidations provisions
- Lease accounting

- Grant accounting in line with the Housing SORP

117. Under FRS 102, with the Housing SORP 2018 providing additional sector-specific guidance, housing associations are required to treat housing properties held for the provision of social housing as fixed assets. To depreciate these properties judgements need to be made on their useful lives, which depend on matters such as property type, method of construction and location.

118. In addition, the depreciation to properties carried out at a valuation, and the need to depreciate only the value of buildings (as distinct from the land on which they are situated) results in additional complexity. The complexity arises from splitting the property into its key components and determining the useful economic lives of these. Housing associations applying the accrual model for grant accounting within FRS 102 recognise grants given by the Government for new social housing in income on a systematic basis over the useful life of the properties' structure, or structure and individual components (excluding land). This impacts on the amount carried in the balance sheet as deferred income.

119. Housing associations must perform an impairment assessment where an indicator of impairment exists. An example of an impairment indicator relevant to a housing association would be a reduction in demand for a property in the local community that is considered irreversible, which will affect its current and future service potential. Impairment losses should be recognised in the income statement. As a result, judgements need to be made regarding the likely future service potential of the property. A reduction in demand is likely to be a more significant factor where the housing association provides particular types of specialist housing.

120. Housing associations must calculate impairments resulting from a major reduction in the service potential of a property that may, for example, result from a reduction in demand in the local community. These should be recognised in the income statement. As a result, judgements need to be made regarding the likely future service potential of the property.

121. Estimating rectification costs where deficiencies have been identified in housing stock is a judgemental area, leading to a potential risk of material misstatement. Some rectification costs may be more difficult to estimate than others; for example, costs to rectify non-compliance with fire safety standards can be particularly complex.

122. In addition, the recording of provisions and contingent liabilities may be complicated where there is a lack of clarity regarding who will pay for rectification costs. In some areas of the UK, government funds have been made available from May 2020 to cover the costs of removing certain types of unsafe cladding. Dependant on the type of cladding, this may cover a proportion or all of the cost.

Internal Controls

123. The responsibility for the establishment and proper operation of a system of internal control lies with the Board of each housing association. Relevant factors for the auditor to consider when planning the work that will be performed on internal controls in the audit of housing associations, include:

- The expectation (in Scotland and Wales, the requirement) that the auditor's management letter will be passed on to the regulator;
- Any additional procedures that have been agreed with those charged with governance;
- Any procedures in place to ensure that the housing association's use of service organisations is subject to appropriate scrutiny and control.

124. Auditors of housing associations that are registered as Co-Operative and Community Benefit Societies are required to state in the auditor's report if, in their opinion, the housing association has failed to maintain a satisfactory system of control over transactions.[9]

[9] Co-operative and Community Benefit Societies Act 2014, Paragraph 87.

ISA (UK) 320 (Revised June 2016): Materiality in Planning and Performing an Audit of Housing Associations

125. The principles of assessing materiality in the audit of a housing association are the same as those applying to the audit of any other entity. In particular, the auditor's consideration of materiality is a matter of professional judgement and is affected by the auditor's perception of the common information needs of users of the financial statements.

126. A key issue in determining materiality for a housing association is that in the statement of financial position line items tend to be much larger than those in the income statement, such that the application of materiality based on income may be too low when auditing some elements of the balance sheet.

127. To address this, the auditor typically uses materiality based on the income statement if a misstatement in a balance sheet item could affect the income statement or accumulated surplus. If, however, a misstatement in a balance sheet item is likely only to lead to a reclassification between line items within assets and liabilities, a higher materiality level may be applied for identifying and evaluating only those misstatements.

128. Although paragraph 10 of ISA (UK) 320 (revised June 2016) indicates that there can only be one overall measure of materiality for the accounts as a whole, ISA (UK) 450[10] states that there may be circumstances involving the evaluation of qualitative considerations where the auditor concludes that a classification misstatement is not material in the context of the financial statements as a whole when the amount of the misclassification is small in relation to the size of the related balance sheet items and the misclassification does not affect the income statement.

129. Additionally, 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.

130. A feature of the business of housing associations is uncertainty relating to the ultimate collectability of rents. As a result, while quantitative measures of materiality are of assistance in directing the focus of the auditor's work, qualitative factors relating to the extent and nature of disclosures in the financial statements will also be of importance. Where such uncertainty is considered to be significant, housing association auditors may consider the disclosures made in the financial statements, and the effect upon the auditor's report.

[10] ISA (UK) 450 (revised June 2016) (Updated July 2017) Paragraphs A14- A29-1.

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

131. Although many businesses utilise service organisations in their operations, housing associations often make significant use of them, frequently to provide repair and maintenance services. As a result, the risk of material misstatements arising as a result of an entity enlisting a service organisation may be greater within a housing association than other entity types.

132. Housing associations often make use of service organisations in the following areas:

- Repairs and remedial work to properties
- Payroll
- Pensions
- Investment management
- Information technology

133. Service organisations are relevant to the auditor when the services provided, and the controls over them, are part of the audited entity's information system. When an audited entity makes use of service organisations, the auditor considers how they may obtain an understanding of the service organisations and controls sufficient to identify and assess risks to material misstatement and then designs and performs procedures appropriately.

134. Housing associations often make significant use of service organisations to provide repairs and remedial works, building into their own internal controls system appropriate controls to address the use of these providers, including approval of budgets, approval of significant individual costs and reviews of works completed.

135. Housing associations, however, still retain responsibility for the function that they have outsourced and should have appropriate controls in place. These controls are likely to include:

- Performance of risk assessment prior to contracting with the service provider, including due diligence and periodic review of the appropriateness of the arrangement;
- Appropriate contractual and/or service level agreements;
- Contingency plans should the provider fail in delivery of services;
- Appropriate management reporting from the outsourced provider; and
- Appropriate controls over customer information for example in relation to data confidentiality and regulations such as GDPR.[11]

136. Where a housing association makes use of a service organisation, the auditor considers their approach to obtaining evidence, including if they may need to visit the service organisation itself in order to perform procedures.

137. It is possible that sufficient appropriate evidence regarding the relevant assertions may be available from records held at the housing association. Where this is not the case, the auditor considers any further procedures that may need to be performed in order to obtain evidence.

[11] General Data Protection Regulation, implemented in the UK by the Data Protection Act 2018.

138. Auditors may be able to make use of Type 1 or Type 2[12] reports that the service organisation has obtained to support their understanding of the controls and systems in place at the service organisation.

139. Auditors should be aware that, where housing associations make significant use of service organisations, efficient and early communication with both the association and the service organisations is likely to be key in ensuring that the auditor is able to obtain sufficient appropriate evidence.

[12] ISA (UK) 402 (Revised June 2016) Paragraphs 13 and 14.

ISA (UK) 520: Analytical Procedures

Analytical Procedures Based on Information Available About the Sector

140. The housing association regulators publish extensive information and statistical data about housing associations. The existence of such information and data can greatly assist auditors by providing an indication of trends and current ratios. In particular, consideration of such data will assist the auditor in developing expectations of plausible relationships among both financial and non-financial information.

141. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Analytical Procedures Specific to a Particular Housing Association

142. Because elements of the income and expenditure of a housing association, for example interest payable and rental income receivable, are predictable, analytical procedures may be suitable for use as substantive procedures.

143. In respect of rental income, for example, the auditor may perform analytical procedures with respect to:

- The number of housing units available for occupation multiplied by the incidence of empty units and the subsequent relationship with revenue and rents receivable;
- Movements, and any unexpected or unusual relationships, between current and prior year budgets for rents received or service charges;
- Movements, and unexpected or unusual relationships, between current year, prior year and budget for voids and bad debts as a percentage of rents; and
- Rents and service charges for each month.

144. Other analytical procedures likely to be of particular use at a housing association include:

- Calculating the expected depreciation for social housing stock by taking account of the brought forward cost, purchases and disposals in the year, the value of fully depreciated assets and the stated usual economic life of the assets;
- In determining the audit evidence that it wishes to obtain with respect to bad debts, the auditor may wish to evaluate the association's stress testing of its business model against these changes.

ISA (UK) 540 (Revised December 2018): Auditing Accounting Estimates and Related Disclosures

145. Housing associations need to make a number of accounting estimates when preparing their financial statements. The main areas where estimates are likely to be required in connection with the core business relate to:

- Fair value of properties held as investment properties;
- Determination of useful economic life for housing properties and separate components of fixed assets;
- The level of bad and doubtful debt provisions against tenant rent arrears;
- Impairments of social housing properties, where significant judgements are taken in calculating a property's value in use;
- Pension liabilities;
- Overhead allocation between different segments of the business;
- Assets and liabilities associated with financing arrangements; and
- Estimates of property rectification costs.

Fair Value of Housing Properties

146. For housing associations, the fair value measurements and disclosures in the financial statements are derived using the methodologies outlined in FRS 102. The auditor assesses:

- The suitability of the valuer selected by the housing association to perform the valuation; and
- The reasonableness of the assumptions used.

Determination of Useful Economic Lives

147. Depreciation charges may be difficult to assess where the useful economic lives of properties are longer than average. In assessing the economic lives of properties, the auditor considers any special factors affecting the housing stock of the particular housing association, such as type of property, location and method of construction.

148. Where no particular special factors have been identified, the auditor may decide to assess the reasonableness of the lives adopted by the housing association by comparing them with those prevalent in the sector. If the housing association's useful lives are out of line with those generally used in the sector, the auditor establishes the reasons for the variance and considers whether the reasons are plausible.

Bad and Doubtful Debt Provisions

149. When evaluating whether adequate provision has been made for bad and doubtful debts, an effective approach is likely to involve consideration of applicable ratios and trends together with an evaluation of the effectiveness of the housing management system. Analytical procedures are likely to be an effective technique because of the high volume of relatively small amounts due to a housing association. When reliance is placed on analytical procedures the auditor considers whether past ratios and trends continue to be applicable in current economic circumstances.

150. The Welfare Reform Act (2012) can potentially lead to adverse effects on the cash flows of housing associations. The use of ratios and trends relating to the period prior to the legislative change may not be relevant following the change. As noted above the auditor may be able to obtain audit evidence about the adequacy of bad and doubtful debt provisions by evaluating the stress testing of its business model against these changes.

Impairment Provisions

151. The SORP 2018 includes guidance on impairment indicators for housing associations. In particular, it observes that financial matters may not be the only aspects to consider in assessing whether a social housing property is impaired and, similarly, a social housing property may not be impaired even when recoverable amounts are below its carrying value.

152. This is based on the premise that a shortfall in value may not be an impairment provided the social benefit is being delivered. Calculation of the value in use of housing properties is a significant judgement area for housing associations and the auditor may therefore need to consider the audit evidence supporting impairment judgements with particular care.

Overhead Allocation

153. Many housing associations undertake a number of diverse activities and the allocation of central overheads between such activities can be an important determinant as to whether such activities appear to be profitable or loss-making. Management may be incentivised to bias the allocation of overheads to hide the true financial status of an activity or subsidiary.

154. Auditors consider, particularly when a subsidiary or business is being disposed of, the allocation methodology applied by management for overheads to determine if it is reasonable and based on observed criteria.

Assets and Liabilities Associated with Financing Arrangements

155. Arising from their traditional funding sources being less willing to advance funds, some housing associations have been entering into more sophisticated financing arrangements such as looking to the wholesale bond markets to satisfy their financing needs.

156. The auditor evaluates whether the housing association's treasury function operates within an appropriate framework of defined policies and procedures including establishing permissible funding and hedging instruments, exposure limits and a system of authorities for approval and execution of transactions.

157. Where applicable, the valuation techniques used to value or disclose such derivative financial instruments may be complex and rely heavily on accounting estimates made by the housing association itself, usually with the advice of external advisers.

Estimates of Property Rectification Costs

158. As housing associations perform detailed reviews of their housing stock to identify deficiencies that require rectification, they may need to estimate the costs to repair properties and bring them up to compliance with relevant health and safety regulation.

159. Where the responsibility lies for rectification can be a complex issue and auditors may consider how the housing association has both estimated the costs to rectify and determined where responsibilities lie. Both of these factors may impact on the accounting and disclosure of rectification costs.

160. Where the rectification work relates to building cladding, some funding is available from the UK Government dependant on the nature of the housing association and the type of cladding. As such, the value of any government assistance and the accounting requirements may be more complex, increasing the risk of material misstatement.

ISA (UK) 570 (Revised September 2019): Going Concern

Periodic Regulatory Viability Assessments

161. The various national regulators may make periodic regulatory viability assessments of individual housing associations and publish the findings of these assessments on their respective websites. The exact process for this varies and depends on the devolved regulatory regime, with different procedures and terminologies used in each region. The latest viability assessment published by the regulator on a particular housing association may form a basis for the auditor's consideration of going concern, but additional work and supporting evidence is also likely to be required to allow the auditor to fulfil their responsibilities in relation to ISA (UK) 570.

Responsibility of the Board

162. The Board of a housing association is responsible for assessing the ability of the housing association to continue as a going concern. The Board's assessment should be documented and rigorous in nature. The Board's process supporting its assessment should be proportionate in nature and depth depending upon the size, level of financial risk and complexity of the housing association and its operations.

163. In assessing going concern, the Board considers the extent to which there may be adverse variations from expected funding or revenue, or additional unexpected costs, and any uncertainties as to whether or not the housing association can continue in operational existence for the foreseeable future. In their assessment of the entities ability to continue as a going concern, the Board should consider if there are any material uncertainties related to events that may cast doubt upon the entity's ability to continue as a going concern. If there is a material uncertainty, this shall be disclosed in the financial statements.[13]

164. Regulators may also require that housing associations stress test their business plans, including against the Bank of England's worst-case scenarios. Auditors may wish to consider the results of any stress test when undertaking work in relation to going concern.

Management and Auditor's Responsibilities in Relation to Going Concern

165. Management are responsible for assessing an entity's ability to continue as a going concern and determining if the disclosure of a material uncertainty is necessary in line with the relevant financial reporting framework.

166. Although the regulator's viability assessment and directors' going concern assessment may be helpful to the auditor, the auditor is still required to meet the requirements of ISA (UK) 570 (revised September 2019).

167. In summary, the auditor is required by ISA (UK) 570, paragraph 17-1, to conclude:

- If, in the auditor's judgement, a material uncertainty relating to going concern exists; and,
- The appropriateness of management's use of the going concern basis of accounting.

168. In applying ISA (UK) 570 (revised September 2019) to the audit of housing associations, auditors consider the circumstances in which housing associations may cease to continue in operational existence. Growing housing associations may have particular going concern risks arising from the necessity they may have to finance housing developments, which may produce short-term negative cash flows. This issue requires an understanding of:

- commitments and future development intentions
- the availability of finance through loan facilities, etc

[13] If applying FRS 102: paragraph 3.9, if applying IFRS: IAS 1, paragraph 25.

- the amount of available security to underpin a necessary loan facility
- the ability to repay the loans, which normally means consideration of a long-term financial plan
- covenant compliance

169. Useful information concerning the assessment of going concern in the current period may be derived from considering the assessment made in the previous period in relation to the housing association's actual subsequent performance,

170. Some of the particular factors that may indicate a potential going concern problem at a housing association are:

- Threatened or actual regulatory intervention by the regulatory body;
- For a transferee housing association, transfers of housing stock where the acquisition cost or carrying value is not covered by the long-term projected net rental income;
- Onerous contractual terms – this may be particularly relevant where the housing association has entered into Public Finance Initiative or Public Private Partnership contracts that may transfer significant risk to the housing association;
- Inability to service interest payments;
- Contracts under 'supporting people', joint ventures or outsourcing agreements becoming unsustainable;
- A significant amount of variable interest rate borrowings at a time when interest rates are predicted to rise: from 2008 until the time of writing interest rates were very low and housing associations with variable interest rate borrowings would become vulnerable in the event that interest rates increased;
- A significant short-term repair obligation that the housing association will have difficulty in meeting from its own resources – such an obligation might arise from government policy such as the Decent Homes Standard issued in 2006;
- A fundamental decrease in demand to rent the housing association's properties, leading to significant void rates and a substantial fall in income;
- A potential increase in bad debts because tenant housing benefit is no longer paid directly to the housing association;
- Loan repayments or refinancing (for example balloon payments) that cannot be met from the housing association's own resources;
- Breaches of loan covenants; and
- Significant loans or guarantees provided to subsidiaries involved in activities such as shared ownership or developments for sale in a housing market where sales prices are falling.

171. Housing associations have a relatively long business cycle and, in preparing financial forecasts, the Board may consider a longer period of time than is common for other types of entities. Indeed, regulatory viability assessments frequently call for cash flow forecasts 30 years into the future, although this period is not usually used for the purposes of assessing the entity's ability to continue as a going concern in line with the relevant financial reporting framework

172. If there are any indications that a particular source of funds or revenue may need to be renewed or renegotiated, the auditor considers requesting the housing association contact the source of such funds for confirmation that the facility, or grant, will continue to be made available to the housing association. In addition, auditors are likely to seek additional supporting evidence; for example, where the source of funds is a loan, the auditor may wish to view executed copies of loan documents, and for grant sources of funding, auditors may wish to view grant

documentation and recent communications with the grant provider. Where there continues to be uncertainty, it may be necessary for the Board to disclose the circumstances in the financial statements and for the auditor to draw attention to the matter in an emphasis of matter paragraph in the auditor's report.

Increasing Complexity of Health and Safety Regulations

173. As described above in the ISA (UK) 250A section, housing associations are subject to a range of health, safety and accessibility legislation, designed to ensure that properties are safe and suitable for tenants.

174. Housing associations that have undertaken significant reviews of their housing stock to determine the extent of potential rectification costs, may identify historic issues requiring remedy. In addition, significant breaches of relevant safety legislation may lead to regulatory penalties being incurred.

175. Going concern may be impacted in cases where the costs to rectify non-compliance with relevant safety legislation are so significant that the housing association is unable to meet that cost. In addition, significant fines or penalties for breaches of regulations may cause financial difficulties within a housing association if they are unable to pay such fines, These factors – individually or in combination – coupled with potential impacts on reputation, may lead to the housing association concluding that is unable to continue for at least the next 12 months, or that a material uncertainty may exist with regards to its going concern status.

Exposure to Significant Economic Disruption, Including Fluctuations in the Housing Market.

176. Properties, whether held for social benefit or as investment property, are the most valuable assets usually owned by housing associations. They are frequently the most significant item on the balance sheet and are often used as security for debts when housing associations are seeking to raise finance.

177. A fall in values on the property market may mean that a housing association is unable to secure debts against a building or may be unable to sell a building and realise as much cash as anticipated, should the housing association need ready access to additional capital.

178. Historically, housing associations have often been able to rely on increasing value in the property market as a buffer for any potential concerns that may affect the entity's ability to continue as a going concern. Auditors, in their work on going concern, consider these factors in reviewing management's assessment of the entity's ability to continue as a going concern.

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

179. Depending on the legal structure of the housing association, a range of both statutory and non-statutory other information may be included alongside the financial statements.

180. This information may include, but is not limited to:

- the report of the Board
- a director's report (where the housing association is a company)
- a strategic report (where the housing association is a company but may also be voluntarily included where the housing association is incorporated under the Co-operative and Community Benefits Societies Act 2014)
- a statement on corporate governance
- a review of value for money
- a review of the principal risks and uncertainties
- a report on social value
- a statement on the effectiveness of the system of internal controls
- Value for Money (VfM) Reporting

181. Unlike the Companies Act 2006, the Co-operative and Community Benefit Societies Act 2014 does not require the preparation of a director's or strategic report and, as a result, any such information included alongside the financial statements is non-statutory in nature. For housing associations in England, a strategic report is required where the association has more than 5,000 homes, irrespective of the legal structure of the association, as per paragraph 4.3 of the Housing SORP.

182. The four devolved regulatory regimes all require some form of VfM reporting, usually containing both narrative reporting on how a housing association is achieving its VfM objectives and the calculation and presentation of specific metrics, including key performance metrics. Auditors may wish to consult the latest guidance on VfM reporting from the relevant regulator's website when reading the other information contained within the VfM report and fulfilling their responsibilities in line with ISA (UK) 720.

183. The auditor's responsibilities as described in ISA (UK) 720 are to read all of the other information included in the housing association's annual report and consider whether there is a material inconsistency between the other information and the financial statements, or the auditor's knowledge obtained in the audit.

184. In addition, the auditor reports by exception on the following matters required by the Co-operative and Community Benefit Societies Act 2014:

- If the association has not kept proper books of account;
- If the association has not maintained a satisfactory system of control over its transactions;
- If the financial statements are not in agreement with the association's books of account; and
- If auditor has not received all the information and explanation they need for the audit.

185. Where the housing association is a company, the auditor's responsibilities regarding other information are outlined in Bulletin: Illustrative Auditors' reports on United Kingdom Private Sector Financial Statement.

186. Where the housing association is a charity, the auditor's responsibilities regarding other information are outlined in PN 11 (Revised) The Audit of Charities in the United Kingdom.

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