WELSH FEDERATION OF HOUSING ASSOCIATIONS

Response to FRED 29 Property, plant and equipment; Borrowing costs

The Federation welcomes the opportunity **to comment on the Financial Reporting** Exposure Draft 29 Property, plant and equipment; Borrowing costs. The Federation, together with its English and Scottish counterparts, is the recognised SORP-making body for registered social landlords (RSLs) in the United Kingdom.
The Federation represents 92 independent not for profit social landlords registered with the National Assembly for Wales owning over 65,000 properties (at 31 March 2001). These include 30 housing associations funded by a combination of Social Housing Grants payable by the National Assembly and loans raised from the capital markets, banks and building societies. They owned 61,000 properties at March 2001

At 31 March 2001 their global balance sheets were as follows:

Fixed assets	
Housing assets at cost	2,321
less: SHG and other public grants	(1,616)
Depreciation	(8)
Revaluation surplus	82
	779
Long term investments	0
Other fixed assets	31
Total fixed assets	**811**
Current assets	
Rent and service charges receivable	10
less: Provision for bad and doubtful debts	(5)
Investments	16
Cash	40
Other debtors	17
Total current assets	**78**
Current liabilities	
Short term housing loans	6
Bank overdrafts	4
Rent and service charges received in advance	2
Re-cycled capital grant fund	7
Other current liabilities	42
	61
Net current assets	**17**
Total assets less current liabilities	**828**
Creditors: amounts falling due after one year	
Housing loans	570
Non-housing loans	2
Other long term creditors	7
Provisions	0
Total loans and provisions	**579**
Net assets	**249**
Capital and reserves	
Accumulated surplus	82
Major repairs reserve	60
Cyclical maintenance reserve	0
Restricted reserves	12
Other designated reserves	12
Revaluation reserves	82
	249

ASB (i) Do you agree with the proposal to issue new UK standards on property, plant and equipment and borrowing costs when the IASB issues the revised IAS 16, unless it becomes clear that further changes to IAS 16 are likely by 2005 as a result of the revaluation project?

Response by WFHA: We would prefer that the new UK standard is only issued after the project is completed so as not to have to deal with successive revisions to the standard.

ASB (ii) The international exposure draft on property, plant and equipment proposes that residual values used in the calculation of depreciable amount should be reviewed at each balance sheet date and revised to reflect current estimates. FRS 15 generally requires prices at the date of acquisition or latest valuation to be used; hence, depreciation expense on a historical cost basis is not reduced by inflation in residual values. Do you agree or disagree with the proposed international approach?

The comparison of the two standards is as follows:

FRS15	FRED29
Review of residual value 95. Where the residual value is material it should be reviewed at the end of each reporting period to take account of reasonably expected technological changes *based on prices prevailing at the date of acquisition (or revaluation).* A change in its estimated residual value should be accounted for prospectively over the asset's remaining useful economic life, except to the extent that the asset has been impaired at the balance sheet date.	Review of residual value 46. The depreciable amount of an asset is determined after deducting the residual value of the asset. In practice, the residual value of an asset is often insignificant and therefore immaterial.. .When the residual value is likely to be material, the residual value is estimated at the date of acquisition and is reviewed as at each balance sheet date. A change in the asset's residual value, other than a change reflected in an impairment loss recognised under FRS 11 is accounted for prospectively as an adjustment to future depreciation. An estimate of an asset's residual value is based on the amount recoverable from disposal, *at the date of the estimate,* of similar assets that have reached the end of their useful lives

Response by WFHA: The review should be based on prices current at the date of the review. Social housing properties typically have very long lives and the residual values will change considerably over time. To maintain residual values at prices which may date back many decades would not be a realistic basis to measure residual values.

ASB (iii) IAS 16 does not address the use of renewals accounting in respect of certain infrastructure assets. Do you believe that the absence of the guidance in FRS 15 would prevent entities from using renewals accounting as a method of estimating depreciation? Should UK entities be permitted to continue to use renewals accounting?

Response by WFHA: Not relevant to housing associations

ASB (iv) What are your views on the differences between the requirements of FRS 15 and IAS 16 concerning revaluations (as described in paragraphs 10 to 17 of the Preface to the FRED)?

The main difference relates to the valuation basis as follows:

FRS 15	FRED 29
Valuation Basis 53. The following valuation basis should be used for revalued properties that are not impaired: (a) non-specialised properties should be valued on the basis of existing use value (EUV)…. Where the open market value OMV is materially different from EUV, the OMV and the reasons for the difference should be disclosed in the notes……….. (b) Specialised properties should be depreciated on the basis of depreciated replacement costs (c) Properties surplus to an entity's requirements should be valued on the basis of OMV	**Revaluations** 30. The fair value of land and buildings is usually its market value. This value is determined by appraisal normally undertaken by professionally qualified valuers

Response by WFHA: The conventional basis for valuing social housing properties is the existing use basis. The market value would be the open market basis of valuation, which is not appropriate.

ASB (v) Are there any other aspects of the differences between the proposed standards and current UK accounting requirements that you wish to comment on?

ASB (vi) Do you agree with the ASB's proposal, as a transitional measure (see paragraph 18 above), that the present exemption in. FRS 15 in respect of insurance companies should be retained in a new UK standard based on IAS 16 revised pending the outcome of the IASB's projects on insurance and reporting financial performance?

Response by WFHA: Not relevant to housing associations

ASB (vii) The transitional arrangements for the first-time application of FRS 15 allowed an entity that does not adopt a policy of revaluation to retain carrying amounts reflecting previous revaluations instead of restating the carrying amounts to historical cost (see paragraph 19 above). Do you believe that a transitional arrangement should be included in a new UK standard to allow entities that adopted FRS 15's transitional arrangement to continue to recognise the carrying amounts under that arrangement?

Response by WFHA: Not relevant to housing associations

ASB (viii) Do you believe that ASB should consider any other transitional arrangements?

Response by WFHA: Not relevant to housing associations

ASB (ix) Are there any other aspects of the draft standard on property, plant and equipment that the ASB should request the IASB to review when finalising the revised IAS 16?.

Response by WFHA: We would like to comment on the following two points:

1. **Initial measurement**

There are differences in the rules for measuring the costs to be capitalised, as follows:

FRS 15	FRED 29
Initial Measurement 8. The cost of a tangible fixed asset comprises its purchase price and any costs directly attributable to bringing it into working conditioning ….. *9. Directly attributable costs are:* (a) *labour costs of own employees arising directly form the construction or acquisition of the specific asset* (b) the incremental costs to the entity that would have been avoided only if the asset had not been constructed or acquired It follows that *administration and other overhead costs would be excluded….* 10. Examples include: (a) Acquisition costs (eg. Stamp duty etc.) (b) costs of site preperation (c) initial delivery (d) installation (e) professional fees	Initial Measurement 15. The cost of an item of property, plant and equipment comprises: (a) its purchase price…… (b) *any directly attributable costs to bring the asset to the location and working condition necessary for it to be capable of operating in the manner intended by management* after deducting the net proceeds from selling any items produced when bringing the asset to that location and condition. 15A Example of directly attributable costs are: *(a) costs of employee benefits* (b) costs of site preparation (c) initial delivery (d) installation and assembly costs (e) professional fees 17. Examples of costs that are not a component of the cost of the property, plant and equipment: (a) costs of opening a new facility (b) costs of introducing a new product (c) costs of conducting business in a new location *(d) administration and general overhead costs* These costs are excluded because they are not part of the asset's purchase price and cannot be attributed directly to bringing the asset to the location and working condition necessary for it to be capable of operating in the manner intended by management

FRS 15 includes a key test in the definition of directly attributable costs:

the incremental costs to the entity that would have been avoided only if the asset had not been constructed or acquired

2. Depreciation method

FRED 29 differs somewhat in describing the alternative depreciation methods, as follows:

FRS 15	FRED 29
Depreciation method 81. A variety of methods can be used to allocate the depreciable amount of a tangible fixed asset on a systematic basis over its useful life. The method chosen should result in a depreciation charge throughout the asset's useful life and not just towards the end of its useful economic life. *Two of the more common methods are:* (a) Straight line (b) Reducing balance	**Depreciation method** 47. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. *These methods include* the straight line method, the diminishing balance method and the sum of the units method

We are conscious of the fact that the draft revision to FRS 15 had proposed disallowing the annuity method of depreciation as an acceptable method of calculating depreciation. We also understand that the draft revision is unlikely to be issued. We would therefore prefer FRED 29 to give a clearer steer as to what methods are acceptable.

ASB (x) Do you agree that the capitalisation of borrowing costs should remain optional? If you had to choose between mandatory capitalisation and prohibition of capitalisation, which would you support and why?

Response by WFHA: Housing associations capitalise interest on their housing developments. Therefore we are content with the present situation of it being optional. If we had to choose between mandatory capitalisation and prohibition we would choose the former, since it is our current practice to capitalise interest.

ASB (xi) Do you agree that paragraph *5(e)* of IAS 23, which allows certain exchange differences to be capitalised, should be deleted in the draft standard on borrowing costs?

Response by WFHA: Not relevant to housing associations

ASB (xii) What are your views on the difference between IAS 23 and FRS 15 referred to in paragraph 24 of the Preface to the FRED concerning borrowing costs eligible for capitalisation?

FRS15	FRED29
Finance costs 21. Only finance costs that are directly attributable to the construction of a tangible fixed asset should be capitalised Directly attributable finance costs are those that would have been avoided (for example by avoiding additional borrowings or by using the funds expended for the asset to repay existing borrowings) if there had been no expenditure on the asset 22. Where the entity has borrowed funds specifically for the purpose of financing the construction of a tangible fixed asset, *the amount of finance costs capitalised is limited to the actual costs incurred on the borrowing during the period in respect of expenditures to date on the asset* 23. Where the funds used to finance the construction.. .form part of the entity's general borrowings, the amount of finance costs capitalised is determined by applying a Capitalisation rate to the expenditure on that asset	**Borrowing costs** 11. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. 13. The borrowing costs that are directly attributable to the acquisition of an asset, are those borrowings that would have been avoided if the expenditure on the asset not been made. When an enterprise borrows funds specifically for the purpose of obtaining a particular asset, the borrowing costs that directly relate to that asset can be readily identified. 15. To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined *as the actual borrowing costs incurred on that borrowing less any investment income on the temporary investment of those borrowings.*

Response by WFHA: We are not sure whether the proposed treatment in FRED 29 would give rise to a more precise measurement of interest to be capitalised. Under FRS 15 housing associations capitalise only the interest costs on the borrowings actually used to develop the tangible fixed asset. In practice housing associations rarely borrow dedicated funds for individual specific developments. If they did so, they would generally only draw down the amount required for the development.

We firmly believe therefore that the requirements of FRS 15 should be retained for housing associations.

ASB (xiii) Do you have any comments on IAS 23 that you wish the ASB to bring to the IASB's attention?

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 16:

IASB (i) Do you agree that all exchanges of items *of property, plant and equipment* should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably (see paragraphs 21 and 21A of the [draft] FRS on property, plant and equipment)?

Response by WFHA: Housing association do occasionally exchange properties between each other. They are usually accounted for at book value, which in the overwhelming majority of cases is historical cost. In those cases where one property is held at valuation by one association and is exchanged for a property which is held at cost by the other, the transferee associations would continue to show the properties at the original book values- cost in the case of one and valuation in the case of the other. We therefore do not agree with the proposal that all exchanges should be measured at fair value.

IASB (ii) Do you agree that all exchanges of *intangible assets* should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably?

Response by WFHA: Not relevant to housing associations

IASB (iii) Do you agree that depreciation of an item of property, plant and equipment should not cease when it becomes temporarily idle or is retired from active use and held for disposal (see paragraph *59* of the [draft] FRS on property, plant and equipment)?

Response by WFHA: We would generally continue to depreciate the asset, although, as indicated in the last sentence of paragraph 59, the association would test such an asset for impairment under FRS 11 and recognise any impairment accordingly.

FRS15	FRED29
Subsequent expenditure 36. Subsequent expenditure should be capitalised in three circumstances: *(a) where the subsequent expenditure provides an enhancement of the economic benefits of the tangible fixed asset in excess of the previously assessed standard of performance* (b) where a component of the tangible fixed asset that has been treated separately for depreciation purposes and is replaced or Restored (c)………………….	**Subsequent expenditure** 23. Subsequent expenditure relating to an item of property, plant and equipment that has been recognised, other than expenditure incurred in replacing or renewing a component of such an item, shall be added to the carrying amount of the *asset when, and only when, it is probable that the expenditure increases the future economic benefits embodied in the asset in excess of its standard of performance assessed immediately before the expenditure was made.*

The differences between the two standards are minor and are unlikely to change the accounting policies of housing associations.