Component Accounting

What is it?
How does it impact Asset and Planned Maintenance Managers?

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What is it?

- A change in the accounting standard relating to the treatment of assets and expenses.

"where the tangible fixed asset comprises two or more major components with substantially different useful economic lives, each component should be accounted for separately for depreciation purposes and depreciated over its individual useful economic life"

- Statement of recommended practice (SORP) now published by NHF.

Who does it apply to?

- Any landlord who owns housing stock needs to implement Component Accounting by no later than March 2012.
  - ***Housing Associations***
  - ***Charities***
  - ***Borough Councils***
  - ***…***
- Component Accounting affects the way in which the annual accounts and reports are prepared.

How big is the problem?

- Assume 10,000 properties:-
  - Broken down in to land, structure and 10 key components.
  - 2000 new surveys per annum (5 year rolling programme).
  - 4000 capital work items completed per annum.
- Initial Implementation:-
  - 120,000 Component Accounting entries need to be created.
  - 10,000 land and structure valuations need to be derived.
  - Not forgetting numerous grant and subsidy records!
- After go live & per annum:-
  - 20,000 updates to the component accounting register as a result of surveys.
  - 4,000 updates as a result of planned maintenance / capital work programmes
  - 1,000 miscellaneous updates as a result of new builds, disposals, voids, etc.

A word of warning!

- The IFRS and SORP vocabulary will be confusing!
- Finance talk about ASSETS…
- Technical services talk about COMPONENTS!
- This can cause a lot of confusion amongst the project team!!!

In practice what does it involve?

- Breaking down properties into:-
  - Land
  - Structure
  - Major Components
- Ascertaining remaining life since last replacement.
- Stating past cost of replacement including staff cost.
- Working out past and present depreciation.
- Apportioning grants and / or subsidies to property level!
- Checking whether the property is worth less than the value determined by the steps above!

Information gaps are the root of the problem!

For example…

- Land
- Structure
- + Any component which has a substantially different useful economic life from the rest of the property:-
  - Kitchens
  - Bathrooms
  - Windows
  - Roofs
  - Heating systems
  - Lifts
  - Wiring

No definite list in the Statement of Recommended Practice (SORP)!

Some good news?

- Some property types are excluded :-
  - Shared ownerships;
  - Properties built for outright sale;
  - Leaseholder stock;
  - Undeveloped land.
- And others are included in a simplified form :-
  - Garages;
  - Commercial properties;
  - Properties under construction – no component accounting until the build is complete!

So whose problem is it anyway?

- Finance?
- Asset Management?
- Both?
- In practice:-
  - initially a multi disciplinary project involving finance, asset management, the board, auditors and lenders!
  - Thereafter a partnership between asset management and finance to keep the register up to date!
  - A complex project with many internal and external stakeholders needing careful management.

Either way Component Accounting puts asset management records under greater scrutiny from finance!

Where does the difficulty lie?

- Recent new build – should have good records!
- 'Older properties' – records may be partial and incomplete.
- Yet, accounts need to be accurate and reliable.
- How far back you go as your starting point is a matter to agree internally and with your auditors!

Options for incomplete records?

- Carry out new surveys.
- Clone records from other similar properties.
- Extrapolate averages from a group of similar properties.
- Value property and apply arbitrary % allocation.
- Use last net book value and apply arbitrary % allocation.
- Last two options would mean using full life from today or…?

Using Asset Management records!

Advantages

- Both Asset Management and Finance records will match from hereon.
- Future planned works updates can be easily applied into the financial records.
- Future investment decisions can be easily analysed as their impact on the financial records can be effortlessly ascertained.
- There will be a need to reverse out from the financial statements existing assets and associated depreciation records.

Disadvantages

- The new financial statements may be significantly different from the current financial statements.
- More work is involved as this will need changes to prior year accounts.
- Such an approach may affect the banking covenants depending on past accounting policies.

Using current Finance Records.

Advantages

- Impact on financial records is reduced as financial records are used to drive component accounting.
- Future depreciation matches more closely previously reported depreciation.
- Work involved in setting up Component Accounting is much less.
- Impact on banking covenants minimised.

Disadvantages

- Asset Management and Finance records will not match closely which may result in skewed investment decisions.
- Two interpretations of a property's condition will exist in the organisation.
- Greater effort will be involved in updating the records going forward – probably impossible to automate such task.
- Audit tasks will remain problematic as reconciliation will prove complex.

A third way in desperation?

- NHF has commissioned Savills to produce a :-

"National Matrix of Property Components"

- It has broad acceptance from auditors.
- BUT can only really be used in exceptional circumstances!
- Would need agreement IN ADVANCE with auditors!
- The Savills property components are:-
  - Structure
  - Roof Structure and covering
  - Windows and external doors
  - Gas boilers / fires
  - Kitchen
  - Bathrooms / WCs
  - Mechanical Systems
  - Electrics
  - Lift

How do you solve it in practice?

- Need to trawl all property records.
- Need to trawl all finance records.
- Need to compare and merge records.
- Need to assess information gaps.
- Need to make assumptions in resolving these.
- Need to validate the assumptions.
- Need to build the new asset register.
- Need to test the impact on the accounts.
- Need to restate accounts on new basis.
- Need to build future interfaces.

In practice using all records is the only solution!

The initial implementation

- Create multi disciplinary team.
- Involve stakeholders in steering committee.
- Understand thoroughly the principles.
- Prepare project plan (crucial).
- Do not underestimate resource and time requirement.
- Don't overlook altering business processes for life after go live.
- Don't forget to review the IT systems needed to support Component Accounting going forward.

Once live…

- Ensure business process and IT integration support effective information sharing between:-
  - Planned Maintenance / Capital Works function;
  - Stock Condition Surveyors;
  - Void inspections;
  - Cyclical works function;
  - Asset management function;
- Audit both asset management register and component accounting register to ensure they remain in sync!

In summary

- Component Accounting:-
  - cannot be avoided.
  - is creating a mass of new records to be maintained.
  - is introducing the need for functions to work more closely together than previously.
  - requires a new IT architecture and new business processes to ensure that costs do not escalate.
- Implement diligently or face the prospect of doing again later!
- Use IT efficiently or drown in inefficiency!
- **Tackle like the introduction of Decent Homes!**

Questions?

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