Implementing Component Accounting - the Housing Association Experience

Introduction

This case study is intended to assist local authority finance staff in their implementation of component accounting by describing a recent experience of implementing component accounting in two medium/large housing associations.

Context

So what is Component Accounting?

Where tangible fixed assets 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.

The overall objective of component accounting is to ensure assets are accurately and fairly included in an organisation's Balance Sheet and that the I & E statement properly reflects the cost of use of those assets.

Housing Association SORP

With the introduction of the SORP Update 2010[1], housing associations and other Registered Providers are required to adopt Component Accounting for the financial years commencing on or after 1 April 2011.

Therefore Housing Associations throughout the UK are currently working to ensure component accounting is fully adopted for the 31 March 2012 financial year-end.

Local Authorities

The requirement to componentise was previously included in the Local Authority SORP.

The "IFRS-based Code of Practice on Local Authority Accounting - 2010/11" which replaced the SORP, places much more emphasis in this area, resulting in more authorities having to componentise their assets.

The Case Studies

The following two case studies are based on a Housing Consultant's experience of implementing component accounting at two housing associations.

Case Study 1

Background

The first association was a large 40,000 unit LSVT[2] organisation. The organisation had been capitalising its investment programme. The quality of data was good, but the stock included a significant number of blocks of high rise flats which increased the complexity of the componentisation. Internally, the project was being led by the finance department. The association had not purchased any software to deal with component accounting.

[1] Statement of Recommended Practice - Accounting by Registered Social Providers (Update 2010)

[2] Large Scale Voluntary Transfer – Where a local authority transfers its housing stock to a Registered Social Landlord, after a ballot of tenants

What was required

The association had not started on the project when the decision to appoint the consultant was made, so the first stage of the project was for the consultant to scope the work needed to implement the changes before 31 March 2012. The scoping document covered the following areas:

- Review of the application of current accounting policy.
- Review of available data for both completeness and quality.
- Preparation of a project plan, setting out the stages, tasks and resources required.
- Preparation of the new accounting policy to get "in-principle" agreement with the external auditors to the proposed changes.

The requirements of the overall project was to prepare fixed assets records at component level, provide a new depreciation calculation, prepare the disclosure for the statutory accounts as at 31 March 2012 and set up procedures and processes to maintain the records going forward.

Challenges

Some of the challenges faced in this implementation:

- With 40,000 houses the volume of data and transactions that needed to be managed meant the spreadsheets were often in excess of 250,000 lines long
- There was a material amount of grant financing the original acquisition of the stock. It had very specific conditions attached so it was necessary to understand these conditions in order to ensure it was correctly treated under the new policy
- Ensuring adequate involvement from appropriate non-finance departments.
- Identifying if there were any leasehold titles to property with less than 50 years left to run?
- The stock was carried at valuation, however its original cost, largely represented by the capitalised investment programme, was very close to the valuation. Therefore it was obvious that the land and structure values were going to be negligible. Understanding this position would require involvement of the valuers.
- This association had not bought a software package for dealing with component accounting and is still considering their IT options. This will result in an interim Excel solution until the overall IT strategy is finalised for finance and related systems

Learning Points

The main specific learning points from this implementation were:

Planning of resources and involvement by all key teams within/outwith the organisation, was crucial, including finance, maintenance, IT, external and internal audit. This ensures understanding of process and data requirements but it also gives an opportunity to ensure ownership of the project is wider than just finance.

In order to ensure the new accounting policy would operate to the organisation's advantage it was necessary to consider **the operational detail** that supported the published policy.

Involving the external auditors was crucial. It gave them significant levels of understanding about the application of the policy before they start their field work as well as getting a worthwhile contribution from them into the policy itself.

An important discussion was regarding keeping the data by estate, but it was **concluded that it needs to be by unit**. Accounting for the disposal of housing units is much more difficult, unless the records are at unit level

It is intended that **internal audit are involved as part of the process.** An independent review on a live basis will increase the confidence levels with the project team, senior management and the external auditors

The quality of investment programme data and the universal **use of a unique property reference number was crucial** to the project. Finance asset data only becomes useful when it can be accurately matched with repairs and investment data by property.

Case Study 2

Background

The second association was a smaller c5000 unit LSVT organisation. The organisation had been writing off its entire investment programme apart from external wall finishes and roofs. The quality of data was good, but required additional information from third parties. Internally, the project was being led by the finance department. The association had purchased a software package to deal with component accounting.

What was Required

The consultant was required to:

- Develop an operational accounting policy that reflected the particular circumstances of the stock.
- Provide input into the system design process.
- Provide componentised fixed asset data
- Provide procedures and processes to support the operation of the fixed asset register

Challenges

Some of the challenges faced in this implementation were

- Actual grant documentation different from initial assumptions made, requiring modelling work having to be re-done
- The organisation had been writing off its investment programme, so required a significant prior year adjustment due to this being a change in accounting policy.
- The componentisation needed to be structured in such a way that the external wall finishes already capitalised weren't now written off.
- A significant amount of data had to come from outside professional firms employed on the investment contract management, this reduced the ability to manage time scales and quality.

Learning Points

The main specific learning points from this implementation are:

The component list needed to be carefully defined and relevant to the association's specific property portfolio. The development of the component list was very much **a team effort** between finance and the technical. Maintenance and investment teams

The decision on **the numbers and types of components** also needed to dovetail with the components in the stock condition survey. Although the stock condition survey had significantly more components than the accounting policy it was possible to get a significant degree of co-ordination between the two documents, which will make the modelling in the long term business planning later in the year, more credible

This association had already taken the decision to **invest in sector specific software** and are now looking at processes and procedures to support that implementation. The good news is that all the work done as part of the planning of the implementation and the development of the accounting policy enabled the system design workshop to be completed without any significant issues in terms of data structure to be resolved.

The finance team originally started with a component for structure and a component for environmental works (roads, paths and boundary works), both with an economic useful life of 50 years. Following discussions with the property maintenance team it became obvious that with the same economic useful life and similar maintenance requirements meant that they could be combined as one component. (However, if the economic useful life of the environmental component had been 35 years and the structure 50+ then it would almost certainly have needed two components)

Summary

The key learning points for local authorities from these two Housing Association component accounting implementations are:

- **In depth planning** is essential, if necessary supported by checking that conclusions are based on accurate information.
- **The starting point for preparing the fixed asset accounting records must be the data sets identified in the planning process** and deciding which groups of data to use, the fewer the better. If necessary most landlords should be able to identify a wide range of data to work from, but the more fragmented it is the more difficult the challenge
- **No two organisations are the same**, both in terms of the process needed for implementation and the requirements for the on-going management of the accounting records.
- Develop an **operational accounting policy that** reflects the needs of the assets.
- **Involve the people** that understand the assets, for example, investment/maintenance teams.
- **Test the quality of data** before committing to any one approach, and if possible have a back-up plan.
- **Consult with the auditors** in depth at an early stage - they can contribute to the process.
- Current thinking is that **eight components is the optimum number** to work to, but there is no absolute right answer, but more components rapidly increases the volume of transactions
- Depending on the size of the organisation, there may be a significant increase in the volume of data to be managed on an on-going basis. Therefore, **a system to manage this efficiently is essential.**
- In terms of structuring the **data preparation exercise it is worthwhile considering it in two parts**; the first part is the work needed to prepare the opening position and then the second part is considering the data, systems and processes needed to maintain the accounting records going forward
- There are **opportunities to keep the numbers of components down** by looking for similarities in terms of lifespan and re-investment patterns. Also to some degree this can be managed by being aware of opportunities with the economic useful lives that are chosen for certain components
- **For those organisations that are dealing with assets at valuation** then the land and structure component will require two sets of records to be compiled and managed; cost and valuation.
- **In terms of structuring data relating to blocks of flats**, firstly with regard to components common to all dwellings and then secondly, service equipment such as lifts and door entry systems, have the same list of components as for all other properties, only considered in two parts.