



"Best overall service award 2011"
Annual Charity Finance Survey

registered providers | component accounting

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background

Component accounting is, for the majority of registered providers, by far the most significant change to accounting requirements arising from the 2010 update to the Statement of Recommended Practice (SORP): *Accounting by registered social housing providers*.

The new SORP is applicable for accounting periods commencing on or after 1 April 2011. It is expected that the component accounting requirement will for many registered providers result in a change in accounting policy which, if its effect on the financial statements is material, will require a restatement of the prior year figures. Therefore, all registered providers need to be formulating their implementation plan as soon as possible.

overview

The principles underlying component accounting are by no means new and are well established in Financial Reporting Standard 15 Tangible Fixed Assets, which stipulates that where an asset is made up of two or more components with substantially different lives each component should be accounted for separately for depreciation purposes, and that expenditure to replace or restore a separate component should be capitalised.

Many providers have for reasons of practicality not followed the above approach fully. It is not uncommon to find providers which depreciate housing properties as whole over a long period of 50 or 100 years without taking account of the fact that they include components such as roofs, windows, kitchens and bathrooms with much shorter lives. In this scenario the cost of replacement bathrooms, for example, would typically be expensed with the effect that in, say, year 10 a property may have had at least one bathroom replaced but the balance sheet would still include the depreciated cost of the original and depreciation of this cost would be set to continue for many more years.

Under component, the requirement to distinguish and separately account for material components is reasserted. The effect of the reasserted requirement on the financial statements for a given year is very likely to be material.

The practical implications are wide and our suggested approach is outlined below.

future policy and practice

Firstly, it is necessary for each provider to determine the components applicable to its assets.

Separate components need only to be accounted for where they have substantially different lives and where the financial effect is material. We would expect that all providers would distinguish a number of different component but efforts should be made to apply materiality to minimise the number of categories treated differently.

Secondly, providers should ensure that adequate systems and records are in place to monitor and account for each component of each asset identified.

The nature of the system change and/or investment required will vary hugely depending on the size of the provider and the adequacy of its existing resources. For all but the very smallest and simplest providers it is likely that there will be a significant impact.

On an ongoing basis, a record of each separate component of each separate asset should be separately depreciated. Where a component is replaced the net book value should be written out of the balance sheet with any loss on disposal taken to expenditure, and the replacement asset should then be capitalised and depreciated.

consideration of restatement of prior year figures

For most providers where material replacement assets were previously expensed, it is likely that the adoption of component accounting will represent a change in accounting policy requiring restatement of the prior year figures unless the effect of the change is immaterial.

This aspect of implementation is likely to prove the most challenging particularly in respect of those replacements assets previously expensed. For assets capitalised previously it is much more likely that comprehensive or at least reasonable records exist but this may not be the case with assets written off as revenue expenditure. In this scenario, resources such as the Matrix published by the National Housing Federation may assist. Providers should, however, be engaging in dialogue with the auditors to ensure that a mutually acceptable approach is adopted from the outset.

For smaller providers with relatively small and steady asset bases, the avoidance of restatement on immateriality grounds may represent a pragmatic solution but it should not be taken as a given and they should collate such evidence as they can to convince both themselves and their auditors that this represents a genuinely defensible position.

Should a restatement be necessary then this will affect the assets and reserves brought forward at the start of the prior year and the results for that year, hence the assets and reserves brought forward into the current year will be affected.

Whilst the principles are clear, practice may be more complicated.

wider considerations

We cannot emphasise strongly enough the need to have a proper and proportionate project plan in place on a timely basis. Without one there is a real risk that the implementation of component accounting will fail. Without getting into the detailed content of such a plan here, we would highlight the need for it to be cross-functional and to involve all stakeholders. A successful implementation cannot be confined to the finance department.

Furthermore, providers with outstanding bank debt need also to exercise caution with regard to the effect of changes on their compliance with loan covenants. It is widely believed in the sector that banks will seek to re-price existing loans where they can find a pretext so it should not be assumed that any covenant changes will necessarily be waived. The effect of proposed changes on loan covenants will be a business-critical consideration in deciding which proposals to implement.

Finally, on a positive note, it should be noted that after implementation many providers will have more comprehensive and accurate asset records, an enhanced ability to track asset history and a better base for future plans. It is to be hoped that these advantages will outweigh the short term pain.

how we can help?

We offer the following services:

Pre implementation assistance including review of existing records, drafting implementation proposals and impact assessments to allow providers to make an informed decision as to the best approach for them;

Systems assessments reviewing the adequacy of systems and procedures in the light of the new requirements and making recommendations for changes and enhancements;

Accounting assistance including calculation of prior year adjustments and assistance with the accounting entries and disclosures;

Facilitation of the project planning process and project plan review; and

Training tailored to the needs to staff or Boards of Management.

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haysmacintyre is a founding member of MSI Global Alliance (MSI), an international alliance of independent legal and accounting firms, with 250 members in 100 countries.



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