

component accounting services

We can ease the burden of the new requirements

Component accounting is coming and it's set to have major implications for financial reporting in the RP sector.

You may not have as long as you think to prepare for the introduction of compulsory component accounting. We take a look at what you should be doing.

What is component accounting?

Component accounting is not a new concept, yet until recently few registered providers of social housing (RPs) applied it. The idea behind it is quite straightforward. If you have an asset, and part of it wears out at a different rate from the rest, then – unless the effect is immaterial – you ought to account for that part separately from the rest of the asset.

A housing property typically comprises of a number of 'components' (e.g. the roof, kitchen, bathroom, windows) which are replaced at varying intervals while the core building continues for a long time. The costs involved in replacing these components are sizeable. It is therefore

not surprising that it has been decided by the Statement of Recommended Practice (SORP) Working Party that component accounting should become compulsory for RPs. This will have major implications for financial reporting in the sector.

Component accounting must be applied across the whole of the housing stock of an association; this will involve a prior year adjustment in the majority of cases. In the first year of application this is likely to result in a sizeable project which will need to be resourced by the association in addition to the normal day-to-day work.

If you are one of the few associations that has already applied component accounting, you need to consider whether your arrangements are consistent with best practice.

The likely date for compulsory application is for accounting periods starting on or after 1 April 2011, although early adoption will be encouraged.

What will the process be?

There are ten key steps each association will need to take.

1. Establish a team that will work on the project, including staff from finance and asset management backgrounds.
2. Prepare an overall plan with the key decision points and the process clearly set out.
3. Agree your sources of data and assess the respective quality of each source.
4. Identify the specific components you will be establishing (this will inevitably be a compromise as too many would be unwieldy).
5. Assess the useful economic lives for each component.
6. Design the IT systems that will store the data. Crucially, take into account that creating the records is only part of the process; they will need to be maintained and kept up-to-date from then on.
7. Agree relevant simplifying assumptions. There are likely to be quite a few of these, and they are incredibly important. If you don't identify them early in the process, you could end up with a considerable amount of unnecessary work. Equally if you agree inappropriate simplifications, you may end up having to repeat parts of the project.
8. Produce the actual analysis from the various sources.
9. Ensure the output created is validated or sense checked.
10. Incorporate the results into the accounting records.

How long will it take?

You may think that you have quite a few months before you need to start worrying about component accounting.

Unfortunately, this is not always going to be the case. We have experience of associations that have applied component accounting early and have found there were many practical difficulties to overcome, and a period of at least 12 months is usually needed from start to finish.

On the basis that you will need to apply this to accounts for the year ended 31 March 2012, i.e. commencing 1 April 2011; this does not provide a huge amount of time. In particular, associations will need to consider incorporating the effects of component accounting in year ended 31 March 2012 budgets, and therefore have a reasonable view of the impact before starting their 2012 budget process. In most cases, this will mean associations will need to have made reasonable progress with component accounting by the autumn of 2010. They should also be updating long-term business plans to reflect the change in treatment.

Given the deadline, we strongly advise associations start planning as soon as possible. It is not going to be an easy process.

How we can assist

We have the expertise to assist you with adopting component accounting and to ease the burden on your organisation.

We have been closely involved in devising the component accounting guidance and have a member on the SORP Working Party, which means we can share our experiences on what these changes will mean for your association. We have also already assisted a number of associations that have adopted component accounting early through their transitional phase and have a wealth of practical advice to provide.

There are many different ways in which we can help.

- Tailored training programmes for the finance and asset management department.
- Easy-to-understand presentations for board members on the theory and impact of component accounting.
- Facilitating the production of the component accounting project plan.
- Working with finance to devise a sensible methodology, including simplifying assumptions.
- Providing IT advice including selecting software and designing bespoke solutions.
- Accounting assistance to produce the detailed calculations for first draft figures.
- Independent validation services in relation to the figures produced.
- Updating or validating long-term business plans in relation to component accounting.
- Assisting with the financial accounting entries and disclosure for first year adoption including prior year adjustments.

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For further information:

Contact	Direct line	Office	Email address
Emma Brett	020 7131 4403	London	emma.brett@smith.williamson.co.uk
Julie Mutton	023 8082 7640	Southampton	julie.mutton@smith.williamson.co.uk
Carl Deane	0117 376 2119	Bristol	carl.deane@smith.williamson.co.uk

Please visit our website for further information: www.smith.williamson.co.uk

Offices: London, Belfast, Birmingham, Bristol, Dublin, Glasgow, Guildford, Salisbury, Southampton and Worcester.

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