

Component accounting - what's the plan?

Introduction

The 2011 audit season was the last one to report under the old Statement of Recommended Practice (SORP). The discussion in 2010/11 on the implementation of the updated SORP (in particular component accounting) almost seemed to eclipse the actual reporting required for the 31 March 2011 year end.

This factsheet sets out the findings from a number of surveys carried out by Grant Thornton and anecdotal evidence from discussions with clients during the audit season.

The information should be taken for what it is - data collected from a number of housing associations across the country at a point when many were preparing for 2012 but had not yet decided on some of the greater detail of their approach to component accounting. We did not artificially balance the sample of respondents to match the general characteristics of the registered provider population so an absolute extrapolation of these findings must be undertaken with caution.

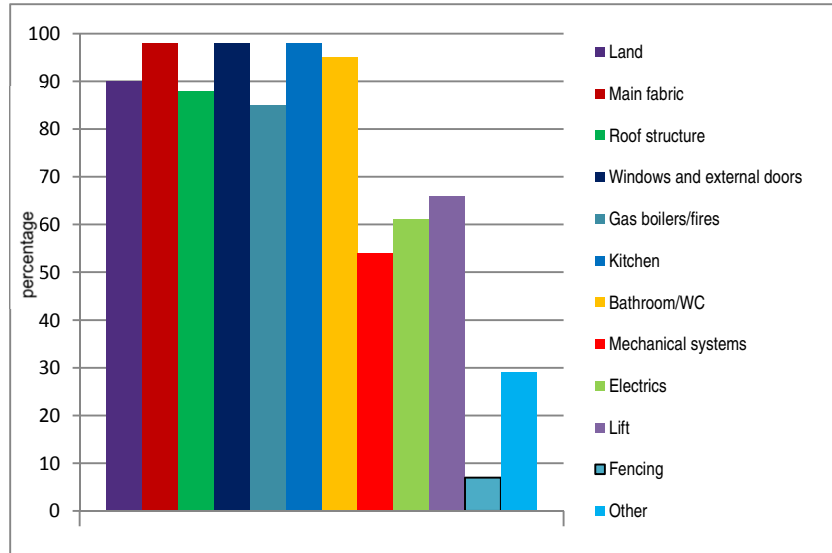
Component accounting

The most discussed element of the updates to the SORP relate to the clarification of the use of component accounting within the sector.

The technical implications have been debated at length and we do not intend to rehearse these here. Instead we have collected various data in relation to current expectations that are emerging as entities work towards full implementation by 31 March 2012.

How many components?

One of the starting points is to determine how many components to have and what level of separation to go down to. The chart below shows that the majority of respondents expect to have between 5 and 7 components. There are no major surprises in the main categories, with the main fabric and windows/doors being the most popular choices (at 98%) along with kitchens. This is as expected given the nature of the properties and the extent to which these areas and bathrooms (not far behind with 95% of respondents selecting it) were used in the examples given in the various discussion documents (and the SORP itself). Not far behind are boilers and roof structures with more than 85% of respondents anticipating that these will be key components.



Regionally, the variations in expectations were minimal, the most notable differences being that only 75% of respondents in London/South East expected to include roofs as a component (compared to 100% elsewhere) and whilst the average was around 72% for lifts being a component this was the case for only 72% of respondents in Yorkshire and the North East. Both these variations though may only reflect the type of properties the respondents in those areas were involved with.

What rate of depreciation?

But perhaps the bigger question is the rate at which respondents expect to depreciate these components.

	0-10 years	11-15 years	16-20 years	21-25 years	26-30 years	30+ years
Roof structure	0%	0%	3%	0%	3%	94%
Windows and external doors	5%	11%	14%	8%	46%	16%
Gas boilers / fires	0%	64%	27%	9%	0%	0%
Kitchen	8%	27%	49%	14%	3%	0%
Bathroom / WC	6%	9%	14%	14%	46%	11%
Mechanical systems (heating, ventilation, plumbing)	8%	15%	15%	23%	27%	12%
Electrics	3%	10%	7%	14%	41%	24%
Lift	7%	7%	22%	19%	26%	19%
Fencing	25%	38%	25%	0%	13%	0%

As would be expected the vast majority (94%) intend to depreciate roofs over 30 or more years, whilst almost 50% are expecting to depreciate windows and doors over 26-30 years. The spread of possible depreciation for windows and doors

(25% expecting between 11 and 20 years) perhaps reflecting the types of windows and doors that might be in place across properties.

84% of respondents expect to depreciate kitchens over less than 20 years with almost 50% expecting this to be between 16 and 20 years. There is a much greater spread of expectations in relation to bathrooms with the majority of respondents expecting between 16 and 30 years.

The anticipated depreciation for electrics is likely to reflect the expectation that in many cases this work would last closer to the life of the fabric of the property (with 65% expecting the life to be more than 26 years).

At this stage we had not asked the rate at which housing associations intend to depreciate the remaining fabric of the property and whether they intend to make changes to the rate at which it was previously included. This is worthy of further investigation as one could argue that there should be an expectation that the main fabric rate goes up as the quicker wearing components are split out.

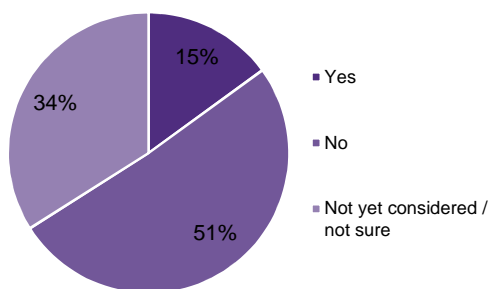
Is the information available?

Anecdotal information suggests that most organisations have now started on the process of collating the necessary information and that whilst larger organisations are bringing temporary staff support into existing teams to work through the information, medium sized associations are more likely to employ consultants to assist, many working closely between their asset management and finance teams to get the real benefit from the exercise. It would appear that smaller associations are having to resort to simply putting more pressure on existing teams in order to implement component accounting.

Will loan covenants be affected?

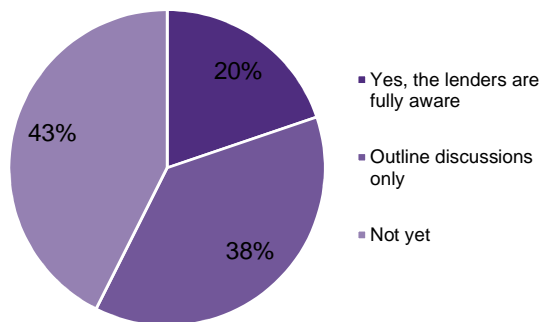
Perhaps the most concern was expressed in respect of the effect that component accounting would have on loan covenants, in particular, many felt this may provide banks with a trigger point for repricing.

Are your loan covenants affected by the implementation of component accounting?



However, as the above chart shows, just over half of our respondents (51%) have assessed the impact as not affecting their loan covenants, with a further 35% not having considered whether this would be an issue at the time of the 2011 audit.

Have you discussed the impact on the financial statements with your organisation's lenders?

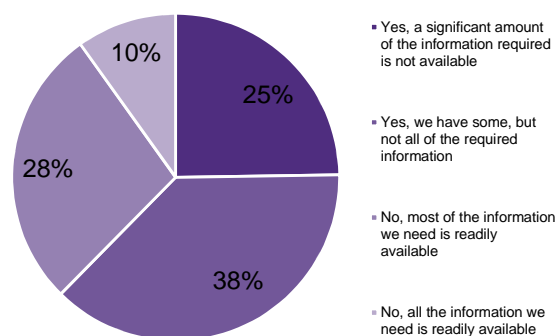


Interestingly, 58% of respondents have had some type of discussion with banks (38% in outline only) suggesting that even where no impact is expected, relationships with banks are being managed to allay any concerns that may have arisen from sector announcements on the update to the SORP.

Is the information available?

But what of the practicalities in relation to actually calculating the impact?

Are you encountering difficulty in obtaining the necessary historical information?



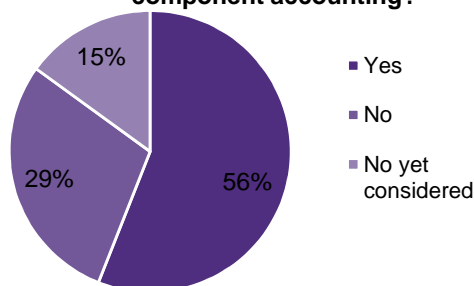
38% of respondents believed they had at least most of the historical information that would be required to fully implement component accounting (of which just over a quarter had all the information needed), leaving 62% without all the information required (of which 40% had a significant amount of the information missing). This very much fits with the

arguments put forward as the implementation requirements were debated.

Many associations are having to agree pragmatic approaches with their auditors where historical information is not available, including the agreeing the period of time over which the effect of having the detail is material.

We intend to collect more data in relation to prior year adjustments. 56% of respondents expected that a prior year adjustment would be required whilst 15% remained undetermined. Without knowing the detail it is difficult to establish whether this represents a difference in approach or other factors during the materiality of the effect.

Do you expect your organisation to require a prior year adjustment on the adoption of component accounting?



Other considerations

50% of respondents had already determined to purchase new software to assist in the implementation whilst 20% had not yet decided at the time of the 2011 audit. More than 60% have determined to maintain the records on an individual property unit level, perhaps suggesting an investment in future information keeping and the intention of a greater level of interaction between the finance and asset management teams.

As we work further towards the 2012 financial statements year end the true impact of the clarification of component accounting will become clear. What is already evident however, is that there will be no uniform approach or impact and that Boards will need to fully understand the implications for their own organisation.

What now?

We intend to relaunch our survey in late November 2011 a point at which we imagine entities will be much closer to determining the detail of their approach to component accounting. This will enable a greater ability to benchmark decisions being made in advance of the final year end preparations. One area we are particularly interested to explore based on feedback from respondents and the audit process is

the period over which associations are expecting to carry out their calculations, in particular, any prior period adjustment.

Who should I contact for assistance?

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