POLICY & FINANCE COMMITTEE **AGENDA ITEM NO. 11**
25 JANUARY 2018

COMPONENTISATION POLICY

1. Purpose of Report

1.1 To approve the new Componentisation Policy with effect from 1 April 2017.

2. Background Information

2.1 The Council is required to present its accounts in accordance with International Financial Reporting Standards (IFRS). The Chartered Institute of Public Finance and Accountancy/ Local Authority (Scotland) Accounts Advisory Committee (CIPFA/LASAAC Code Board under the oversight of the Financial Reporting Advisory Board has developed the Code of Practice on Local Authority Accounting (LAA COP) based on IFRS, to be applied to accounting periods beginning on or after 1 April 2017.

2.2 The move to an IFRS-based Code from a UK GAAP-based Statement of Recognised Practice (SORP) results in a number of significant changes in accounting practice. These include a greater emphasis on component accounting, and derecognising parts of an asset that are replaced.

2.3 As the Council has not yet implemented component accounting it has now been raised as an audit requirement following the 2016/17 final accounts audit.

2.4 Due to the extent and complexity of the changes and the limited time available to do the work officers have had to start work on applying the requirements to the Council's fixed assets. Our approach reflects guidance obtained from professional bodies, attendance at training courses and discussions with our external auditors. As a result, changes may be required in the way we have applied the requirements.

CODE REQUIREMENTS

Extract: IFRS 2016-17 LAA COP (4.1.2.43)
Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. Where there is more than one significant part of the same asset which has the same useful life and depreciation method, such parts may be grouped in determining the depreciation charge. In practice this can be achieved by only separately accounting for significant components that have different useful lives and/or depreciation methods. The requirement for componentisation for depreciation purposes shall be applicable to enhancement and acquisition expenditure incurred, and revaluations carried out, from 1 April 2010.

3. Proposals

3.1 CIPFA have produced guidance on the level of componentisation and have stated:

A pragmatic and sensible approach is recommended and only significant components will need to be separated out. The measure of what is 'significant' is again a judgment but is based on the cost of the component in relation to the total value (cost) of the overall asset.

The CIPFA guidance suggests that it is unlikely that there would be a need to identify several components, typically four components for any particular asset is deemed reasonable. The number and type of components will vary from asset to asset but might typically include such elements (components) as the roof, mechanical & electrical equipment/installations, and site infrastructure. The final decision will depend upon the particular circumstances and appropriateness of each case.

(Source: CIPFA Property Asset transfer Unit IFRS Guide Framework. June 2010).

Based on the above guidance, the Council will consider for componentisation the following;

- Assets of Property, Plant and Equipment, with a carrying value of £1,000,000 or more.
- The asset components are split at high level into Land and Buildings with the buildings element further subdivided, in order to be depreciated over different estimated useful lives each component, as a significant element will be based on cost of 10% or above, of the total asset value and may include for example;
  - Building Structure
  - Building Roof
  - Building Mechanical and Electrical (M&E) ie lifts, boilers etc

  For the Housing Stock the de-minimis will not apply and the categories will be
  - Building structure which includes the roof
  - Kitchens
  - Bathrooms
  - Electrical wiring
  - Heating system

3.2 The Council has adopted this component structure based on an analysis by the Council's valuers of building project costs published by the Building Cost Information Service (BCIS) of the Royal Institution of Chartered Surveyors (RICS) and, in relation to the Housing Stock, Communities and Local Government guidance. The structure also mirrors emerging approaches taken by surveying firms in the private sector who are experienced in undertaking valuations for public sector capital accounting.

3.3 The land component value is based on the Council's valuers knowledge of land values applicable to areas within Newark and Sherwood District.

3.4 The Asset Register is fully compliant with the requirements of componentisation.

3.5 Componentisation will take effect from 1 April 2017 and in line with the requirements of the Code, only assets which have been acquired, enhanced or revalued will be componentised and have their estimated useful lives updated, thereby achieving progressive compliance over 5 years.

APPLICATION OF THE REVISED POLICY: DETERMINATION OF THE ESTIMATED USEFUL LIFE OF COMPONENTS

The estimated useful life of the identified components depends on the component initial useful life and the age and condition of the component. In an ideal world the assessment of age and condition and the estimated remaining life of components would be undertaken by way of a condition survey carried out by a team of building surveyors. This would be both time-consuming and costly.

The upper level for estimated useful life has been established following analysis of data published by BCIS. This comprised a survey of the life expectancies of common building components based on the experiences of 80 building surveyors. The most common sample size in respect of each component in the survey was 56, so the data covers a good number of projects.

The following table is based on analysis of data from this survey with average values for the typical maximum life expectancy of aggregated building components being produced.

Component	Typical maximum life expectancy
Building Structure = substruction and superstructure and including internal walls, windows and doors, but excludes roof (except on Housing Stock), finishes and fittings	50 years
Non-traditional roof = flat roof types and non-traditional pitched	35 years
Traditional Roof = pitched/tiled excluding thatch	50 years
M & E (services) = water, heat, ventilation, electrics, lifts, fire, communications	20 years
<u>Housing Stock</u> (Structure and Roof as above)	
Kitchens	20 years
Bathrooms	30 years
Electrical wiring	30 years
Heating Systems	22.5 years

<u>APPLICATION OF REVISED POLICY: APPORTIONMENT OF EXISTING BALANCES TO COMPONENTS</u>

Accumulated depreciation attached to an asset will be attributed to the main asset ie building structure.

Revaluation gains & losses attached to an asset will be attributed to the main asset ie building structure.

Existing impairments attached to assets will be attributed to the main asset ie building structure.

<u>APPLICATION OF REVISED POLICY: APPORTIONMENT OF FUTURE REVALUATIONS AND IMPAIRMENTS TO COMPONENTS</u>

The impact of revaluation gains or losses that arise in the future will be applied to the main asset ie building structure.

All components will be reviewed annually for impairment and where the impairment was due to a specific part of an asset will be attached to the specific component. Where new impairments relate to the asset as a whole due to a decrease in market values on properties valued to Fair Value (Existing Use) and Fair Value (Depreciated Replacement Cost) will be applied to the main asset ie building structure.

Where the carrying amount of a replaced component cannot be determined the Council will use an estimated replacement cost indexed back to the inception of the component.

Where reversing a previous loss the reversal will be matched to the existing component carrying the impairment.

Impacts on previously approved Accounting Policies in relation to Property, Plant and Equipment will be reviewed and amended accordingly in line with these policies.

RISKS AND UNCERTAINTIES

Work is on-going to identify components and finalise valuations as at 31 March 2018. Enhancements and new acquisitions capitalised at 31 March 2018 are also required to comply with this policy. The Accountants and Valuer are working together to ensure compliance. However, a number of risks and uncertainties remain which could require changes to the way in which the revised policy is implemented.

Risk/Uncertainty	Possible impact	Mitigation
The fixed asset register is found to be unable to support the proposed treatment.	Required outputs cannot be obtained or are incorrect. Statement of accounts cannot be completed to required timescales.	After consultation with Logotech on the capabilities of the system. Testing will be undertaken as soon as possible. Changes to the application of the policy may be required to enable use of the system.
External auditors may not agree with the Council's interpretation of the Code or existing guidance.	Accounts may be materially misstated, rework and further audit work may be necessary.	The policy and decisions have been discussed with KPMG and they have indicated that they are minded not to challenge the basis of componentisation. Continued consultation with the external auditors on an on-going basis. Implement their guidance as required.

4. RECOMMENDATION

That the proposed accounting componentisation policy be approved.

Reason for Recommendation

To enable the Council to comply with International Financial Reporting Standards (IFRS).

Background Papers

CIPFA LAAP Bulletin 86 (Updated)
For further information please contact Andrew Snape on Ext 5523.

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