



# Financial Reporting Advisory Board Paper

## IFRS 13 Fair Value Measurement

<b>Issue:</b>	At FRAB 121 HM Treasury and CIPFA updated the Board on proposals for introducing IFRS 13 into the FReM and the Code for 2015-16. Consultation on FReM and Code amendments took place over the summer. This paper provides the Board with a review of the responses received and the amendments that will be made to the FReM and Code.
<b>Impact on guidance:</b>	Yes, the FReM, Code and other Manuals will require amendment.
<b>IAS/IFRS adaptation?</b>	Yes, adapts IAS 16 and IAS 38. No adaptations are proposed to IFRS 13.
<b>Impact on WGA?</b>	Yes
<b>IPSAS compliant?</b>	The IPSAS Conceptual Framework allows a range of measurement bases dependent on what is most appropriate for holding the entity to account and for decision making purposes. The proposal outlined in this paper is consistent with IPSAS.
<b>Interpretation for the public sector context?</b>	Yes, interprets IAS 16 and IAS 38 for the public sector context.
<b>Impact on budgetary regime?</b>	Changes in asset values will impact on depreciation charges.
<b>Alignment with National Accounts</b>	Proposals retain alignment with national accounts. Current market prices are used for assets in the national accounts, but alternative valuation methods are allowed where an active market does not exist.
<b>Impact on Estimates?</b>	Changes in asset values will impact on depreciation charges.
<b>Recommendation:</b>	HM Treasury and CIPFA ask for the Board's final views on the proposals to introduce IFRS 13 into the FReM and Code in 2015-16.
<b>Timing:</b>	Adoption is planned for 2015-16.

## Background

1. The Treasury published Exposure Draft 13(01) on IFRS 13 in July 2013 which proposed that IFRS 13 should be adapted such that it did not apply to assets which were subject to restrictions on geographic location. After considering the responses to the Exposure Draft, the Treasury put forward a recommendation that IFRS 13 should be adopted in full with no adaptation, but with enhanced guidance in the FReM to explain the restrictions that are likely to apply in the public sector.
2. Following the consultation and further discussions at the FRAB, the Treasury and CIPFA concluded that exit values are not appropriate for most public sector assets, because most public sector assets are specifically held for their service potential. The Treasury and CIPFA therefore presented a final proposal at the April 2014 meeting which focused on whether an entity is holding an asset primarily for its service potential as an operational asset, or for financial returns either as an investment property or through being held for sale.
3. At FRAB 121, HM Treasury and CIPFA asked the Board to provide comments on Exposure Draft 14(01) that had been prepared on the basis of the agreed approach, and to agree plans for due process consultation and follow-up review. Over the summer due process consultation took place, and this paper provides the Board with an overview of the responses and the final recommended amendments to the FReM and Code for 2015-16.

## FReM Exposure Draft - Responses to the Consultation

4. The Treasury received 11 responses to Exposure Draft 14(01). A summary of the responses and how Treasury is responding to them is included in the Annex. On the whole respondents were largely supportive with most agreeing to the proposals and the proposed effective date. A consistent theme, however, was a request for clarification for when an asset is not being used to deliver public services and there is no plan to bring it back into use, with no restrictions on sale, and it does not meet the IAS 40 and IFRS 5 criteria.
5. After considering the responses to the Exposure Draft, HM Treasury have therefore introduced an additional surplus category under the 'Assets not held for their service potential' valuation basis. This category will effectively be a 'residual' category when an asset does not meet IFRS 5 'Asset Held for Sale' criteria and additionally does not meet the IAS 40 'Investment Property' criteria. Under this category an asset will be measured at fair value using IFRS 13.
6. The typical valuation basis that will arise is set out below:

	Valuation basis	
	Existing FReM	2015-16 FReM
<b>Assets held for their service potential</b>		
→ In use	Market value in existing use	Market value in existing use
→ Surplus		
→ Restrictions on sale	Market value in existing use	Market value in existing use
→ No restrictions on sale	Market value in existing use	Highest and best use

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**Assets not held for their service potential**

→ Investment property	Highest and best use	Highest and best use
→ Held for sale	Market value in existing use or highest and best use	Market value in existing use or highest and best use
→ Surplus		Highest and best use

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7. The Treasury did receive one response from the Department for Transport that Board members views are requested on.
8. The department agreed that the proposals made sense for the overwhelming majority of assets held to deliver a public service, where the service must be delivered from that location and/or using those specific assets. In this case, where there is no scope to dispose of the assets, the exit valuation approach that underpins IFRS 13 does not provide decision-useful information to readers of the accounts. They noted, however, that there are some instances where a government body holds an asset or assets to provide services on a commercialised basis, where the services are a means towards the objective of generating cash flows from external customers. In some cases, there may be a long-term strategic objective of ultimately privatising the service, or at least introducing more private-sector disciplines. In such instances, a depreciated replacement cost or market value for existing use valuation may not provide the best information about whether the service delivery is meeting those objectives.
9. The department, therefore, proposed the following amendment:
 

“For assets which are held for their service potential, but where the entity’s business model is to hold the assets to generate future inflows of economic benefit, the entity may irrevocably elect to apply IFRS 13 without interpretation.”
10. In this context the department indicated that “business model” is used in the same sense as in IFRS 9: a strategic decision, determined by key management personnel, which sets out how the entity plans to create value from the resources. Across government, where the business model for a specific function/service is to generate future inflows of economic benefit then the department believes that application of IFRS 13 will help identify whether the strategy is succeeding or failing on its own terms.
11. Members are requested to comment on the merits of this proposal.

**Code Exposure Draft - Responses to the Consultation**

12. As a part of its conceptual approach to the measurement of property, plant and equipment CIPFA/LASAAC decided to introduce the concept of current value to its measurement requirements for PPE. Under this overarching concept the Code introduces four current value measurement bases existing use value, existing use value - social housing, DRC and fair value.
13. The responses to the consultation were in the vast majority of cases supportive of the approach to the adoption of IFRS 13 and the measurement of PPE with only one respondent (an audit firm) not supporting this conceptual approach. Two respondents did not consider fair value to be a current value measurement. However, CIPFA/LASAAC considered that fair value as a

current cost is supported by the latest staff draft of the IASB Conceptual Framework and therefore it agreed to proceed with this approach.

14. A number of respondents raised concerns about the level and complexity of IFRS 13 disclosures, their application to local government circumstances and particularly their potential for overburdening the financial statements with excessive detail which would obscure the key messages in relation to the fair value measurement of transactions. CIPFA/LASAAC debated this issue in detail and considered the option of including rebuttable presumptions on application and materiality. However, the Board decided to adopt the disclosures without any substantial changes but to include a statement on materiality at the beginning of the disclosure section on IFRS 13 (see Draft Code paragraph 2.10.4.1)
15. The Exposure Draft also included the objectives of IFRS 13 disclosure requirements in the section of the Code which adopts IAS 16 (see paragraph 4.1.4.2). However, this raised further concern from respondents about the level of detail included in the financial statements from a substantial number of respondents. CIPFA/LASAAC decided not to proceed with this approach and to include instead a requirement for local authority financial statements to include in their accounting policies on PPE the measurement techniques for significant categories of assets.

### **Recommendation**

16. HM Treasury asks for the Board's views on the proposal raised by the Department for Transport in response to the Exposure Draft. Subject to those views, HM Treasury and CIPFA ask for the Board's agreement on the final proposals for the introduction of IFRS 13 into the FReM and Code for 2015-16.

**HM Treasury, CIPFA**

**27 November 2014**

## Annex A – FReM consultation responses

Respondent	Summarised response	HMT response (where applicable)
DFPNI	<p>Agree with the proposals and the proposed effective date with the following notes:</p> <ul style="list-style-type: none"> <li>• Requested additional guidance on the practical application</li> <li>• Asked whether materiality would be taken into consideration and cost if additional valuations were required with no material impact on the accounts</li> </ul>	<p>HM Treasury is considering whether additional guidance is necessary. If so this will be made available in time for the 2015-16 financial year.</p> <p>The HMT Simplifying and Streamlining project is placing further emphasis on materiality – areas such as this should be considered by entities where appropriate.</p>
DEFRA	<p>Agree with the proposals and the proposed effective date with the following note:</p> <ul style="list-style-type: none"> <li>• Request clarification on their interpretation that if a specialist property was made surplus it would be valued at highest and best use regardless of existing use.</li> </ul>	<p>HMT can confirm that this interpretation is correct.</p>
DHSS	<p>Agree with proposals with the following notes:</p> <ul style="list-style-type: none"> <li>• Request for guidance on simple, clear presentation of disclosures</li> <li>• Agree with the proposed effective date while noting that earlier notification would have made forecasting for 15/16 budgets easier</li> </ul>	<p>HM Treasury will consider providing additional guidance on disclosures as part of further work around Simplifying and Streamlining</p>
DWP	<p>Agree with the proposals and the proposed effective date.</p>	
Monitor	<p>Agree with proposals and the proposed effective date with the following notes:</p> <ul style="list-style-type: none"> <li>• Recommend that FReM encourages public sector entities to be mindful of the potential alternative use of assets when its current use</li> </ul>	<p>HM Treasury does not intend to include this in the FReM but agrees that entities should be mindful of the potential alternative use of assets.</p>

	<p>differs from high and best use.</p> <ul style="list-style-type: none"> <li>Note the change will lead to FTs recognising impairments of surplus specialised assets and revaluation gains on surplus non-specialised assets earlier. Monitor is comfortable with the proposal but is currently unsure of the overall impact.</li> </ul>	
DH	<p>Agree with the proposals and proposed effective date with the following note:</p> <ul style="list-style-type: none"> <li>NHS Property Services, which holds high value surplus NHS estate, is a Companies Act company and therefore may need to maintain two sets of valuations for the stand alone and consolidate accounts – therefore facing increase valuation costs</li> </ul>	
MOD	<p>Agree with the proposals and proposed effective date with the following exception:</p> <ul style="list-style-type: none"> <li>Removal of paragraph 7.1.9 of the FReM. MOD are concerned that this removes the distinction between property and non-property and the differing accounting treatment. They are concerned that a process of quinquennial valuation supplemented by annual indexation will be required for SUME, Plant and Machinery and Transport asset which has previously not been required, will be costly and open up audit risks.</li> </ul>	<p>This was not HM Treasury's intention. The FReM will be amended to ensure that the distinction between property and non-property is clear.</p>
MOJ	<p>Agree with the proposals and the proposed effective date.</p>	
FCO	<ul style="list-style-type: none"> <li>Minor amendments to the flowchart in the FReM suggested to capture the</li> </ul>	<p>Change has been made to the flowchart.</p>

	<p>requirement to measure surplus assets at fair value</p> <ul style="list-style-type: none"> <li>• Concern that significant Level 3 disclosures will be required for a small number of relatively low value buildings (surplus assets and investment assets) which will add to the reporting burden and cost.</li> <li>• Clarity on what would constitute 'surplus' and what types of restriction on sale would mean an asset was not surplus requested</li> </ul>	<p>In line with the recommendations in the Simplifying and Streamlining project materiality should be considered in these cases.</p> <p>HM Treasury is considering whether additional guidance is necessary. If so this will be made available in time for the 2015-16 financial year.</p>
DCLG	<ul style="list-style-type: none"> <li>• Request clarity as to whether HMT will be issuing an ED or further guidance on IFRS 13 and financial assets</li> <li>• Request for a definition of assets 'in use' and 'surplus'</li> <li>• Confirmation that treatment of assets that are partially in use and partially surplus is the same as multi-use building is required</li> <li>• Clarification of treatment when an asset is not in use and there is no plan to bring it back into us, with no restrictions on sale, however does not meet the IAS 40 and IFRS 5 criteria.</li> </ul>	<p>HM Treasury will not be issuing further EDs but may provide additional guidance on financial assets if there is uncertainty over treatment.</p> <p>HM Treasury believes that this is sufficiently clear to not require further definition.</p> <p>Yes, this would be the expected treatment.</p> <p>Amendment has been made to introduce a residual category of assets that do not meet IAS 40 or IFRS 5 criteria.</p>
DfT	<p>Agreement that makes sense for the overwhelming majority of assets held to deliver a public service.</p> <p>However, where a government body holds an asset or assets to provide services on a commercialised basis, where the services are a means towards the objective of generating cash flows from external customers then a depreciated replacement cost or market value for existing use valuation may not provide</p>	<p>HM Treasury can see technical merit in this proposal and would welcome Board members views.</p>

	<p>the best information about whether the service delivery is meeting those objectives.</p> <p>Propose the following amendment:</p> <p>“For assets which are held for their service potential, but where the entity’s business model is to hold the assets to generate future inflows of economic benefit, the entity may irrevocably elect to apply IFRS 13 without interpretation.”</p>	
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## ANNEX B –FRem Amendments

Although IFRS 13 is applied without adaptation, IAS 16 and IAS 38 have been adapted and interpreted for the public sector context to limit the circumstances in which a valuation is prepared under IFRS 13.

<b>IAS 16 Property, Plant and Equipment</b>	
Adaptations	<p>IAS 16 is adapted to specify the following valuation bases for property, plant and equipment:</p> <ul style="list-style-type: none"> <li>- Assets which are held for their service potential (i.e. operational assets) and are in use should be measured at current value in existing use. For non-specialised assets current value in existing use should be interpreted as market value for existing use. In the RICS Red Book, this is defined as Existing Use Value (EUV). For specialised assets current value in existing use should be interpreted as the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential.</li> <li>- Assets which were most recently held for their service potential but are surplus should be valued at current value in existing use as above if there are restrictions on the entity or the asset which would prevent access to the market at the reporting date. If the entity could access the market then the surplus asset should be valued at fair value using IFRS 13.</li> <li>- Assets which are not held for their service potential should be valued in accordance with IFRS 5 or IAS 40 depending on whether the asset is actively held for sale. <b>Where such assets are surplus and do not fall within the scope of IFRS 5 or IAS 40 they should be valued at fair value using IFRS 13.</b></li> </ul>
Interpretations	<p>(1) All tangible non-current assets shall be carried at either current value in existing use or fair value at the reporting date - that is, the option given in IAS 16 to measure at cost has been withdrawn, as has the option to value only certain classes of assets</p> <p>(2) It is not necessary to disclose the historical cost carrying amounts (where available)</p> <p><b>Further application guidance on accounting for property, plant and equipment, including heritage assets, networked assets and PPP arrangements, is included in chapter 7.</b></p>
<b>IAS 38 Intangible Assets</b>	
Adaptations	<p>Following the initial recognition of an intangible asset, for subsequent measurement IAS 38 permits the use of either the cost or revaluation model for each class of intangible asset. Where an active (homogeneous) market exists, intangible assets other than those that are held for sale should be carried at current value in existing use at the reporting period date – that is, the cost option given in IAS 38 has been withdrawn and the current value should be based on the market value in existing use. Where no active market exists, entities should revalue the asset, using indices or some suitable model, to the lower of depreciated replacement cost and value in use where the asset is income generating. Where there is no value in use, the asset should be valued using depreciated replacement cost.</p> <p><b>Chapter 7 provides application guidance for Carbon Reduction Commitment (CRC) Energy Efficiency Scheme</b></p>
<b>IFRS 5 Non-current Assets Held for Sale and Discontinued Operations</b>	
Interpretations	<p>In order to qualify as 'discontinued operations', the activities must cease completely: that is, responsibilities transferred from one part of the public sector to another (such as machinery of government changes) are not discontinued operations.</p>

## 6 Further guidance on accounting for assets and liabilities *Property, plant and equipment (PPE)*

Valuations (excluding networked assets, donated assets and heritage assets)

- 6.1.1 In considering how best to apply the valuation requirements of IAS 16 so as to ensure that the Statement of Financial Position gives a true and fair view of the value of the assets at the reporting date, entities should consider the following guidance on property and non-property assets. The flowchart at the end of this section will assist in determining the appropriate accounting treatment of PPE excluding networked assets, donated assets and heritage assets.
- 6.1.2 Entities should value their PPE using the most appropriate valuation process. Such processes might include:
- a quinquennial valuation supplemented by either annual indexation or regular desktop valuation update
  - a quinquennial valuation supplemented by an interim professional valuation in year 3;
  - annual valuations; or
  - a rolling programme of valuations.
- 6.1.3 It is for valuers, using the Royal Institution of Chartered Surveyors; (RICS) 'Red Book' (RICS Valuation - Professional Standards), and following discussions with the entity, to determine the most appropriate methodology for obtaining either a current value in existing use or a fair value.
- 6.1.4 Assets which are held for their service potential (i.e. operational assets used to deliver either front line services or back office functions) should be measured at their current value in existing use. For non-specialised assets current value in existing use should be interpreted as market value in existing use which is defined in the RICS Red Book as Existing Use Value (EUV). For specialised assets current value in existing use should be interpreted as the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential.
- 6.1.5 Assets which were most recently held for their service potential but are surplus should be valued at current value in existing use as per paragraph 7.1.4 if there are restrictions on the entity or the asset which would prevent access to the market at the reporting date. If the entity could access the market then the surplus asset should be valued at fair value using IFRS 13.
- 6.1.6 In determining whether an asset which is not in use is surplus, management should assess whether there is a clear plan to bring the asset back into future use as an operational asset, where there is a clear plan, the asset is not surplus and the current value in existing use should be maintained. Otherwise, the asset should be assessed as being surplus and valued under IFRS 13.
- 6.1.7 Assets which are not held for their service potential should be valued in accordance with IFRS 5 or IAS 40 depending on whether the asset is actively held for sale.
- 6.1.8 **When an asset is not being used to deliver services and there is no plan to bring it back into use, with no restrictions on sale, and it does not meet the IAS 40 and IFRS 5 criteria, these assets are surplus and should be valued at fair value using IFRS 13.**
- 6.1.9 Where a valuer, following discussion with the entity, determined that depreciated replacement cost (DRC) is the most appropriate measure of current value in existing use, entities and their valuers should have regard to the guidance contained in the most recent RICS Red Book.
- 6.1.10 Where DRC is used as the valuation methodology:
- entities should normally value a modern equivalent asset in line with the Red Book. Any plans to value a reproduction of the existing asset instead should be discussed with the relevant authority (through sponsoring bodies where appropriate) to determine whether such an approach is appropriate to the entity's circumstances.
  - entities should use the 'instant build' approach;
  - the choice of an alternative site will normally hinge on the policy in respect of the locational requirements of the service that is being provided.
- 6.1.11 The cost of enhancements to existing assets (such as building of a new wing within an existing prison or adding a lane to a motorway) should be capitalised during the construction phase as an asset under construction. At the first valuation after the asset is brought into use, any write

down of cost should be treated as an impairment and charged to the Statement of Comprehensive Net Expenditure.

6.1.12 Entities should:

- disclose in the accounting policies note the fact that assets are carried at current value in existing use or fair value. Entities should also provide information about the approach to valuing their estates, including a statement (where applicable) that alternative sites have been used in DRC valuations;
- disclose in the notes on tangible non-current assets: the date of the last valuations of those assets that are subject to revaluation, and the names and qualifications of the valuer; and
- discuss in the Management Commentary, where they hold extensive estates: their estate management strategy; the indicative alternative use values provided by the valuer as part of the routine valuation work, and what those alternative use values mean in terms of their estate management policy.

6.1.13 As part of the Property, Plant and Equipment note entities are required, in the year the asset is acquired, to separately disclose the current value in existing use or fair value of those assets funded by government grant, donation or lottery funding. Where the funder provides cash, rather than the physical assets, any difference between the cash provided and the fair value of the assets acquired should also be disclosed.

6.1.14 Entities may elect to adopt a depreciated historical cost basis as a proxy for current value in existing use or fair value for assets that have short useful lives or low values (or both). For depreciated historical cost to be considered as a proxy for current value in existing use or fair value, the useful life must be a realistic reflection of the life of the asset and the depreciation method used must provide a realistic reflection of the consumption of that asset class. If depreciated historical cost is used as a proxy for current value in existing use or fair value then this fact should be disclosed, including the classes of assets where it has been used (where appropriate), the reasons why, and information about any significant estimation techniques (where applicable).

**Flowchart of valuation for property, plant and equipment (excluding networked assets, donated assets and heritage assets)**

