HM Treasury

Thematic Review of Non-investment Asset Valuation for Financial Reporting Purposes

Consultation Paper

March 2023

This publication is available at: www.gov.uk/official-documents.

Any enquiries regarding this publication should be sent to us at public.enquiries@hmtreasury.gov.uk

Contents

Chapter 1

Introduction

1.1 HM Treasury has published this Consultation Paper to consult on changes that will affect Financial Reporting Manual (FReM) adaptations and interpretations of International Accounting Standard 16 *Property Plant and Equipment* (IAS 16) and adaptations of International Accounting Standard 38 *Intangibles* (IAS 38), in respect of the measurement of assets. These changes flow from HM Treasury's Thematic Review of non-investment asset valuations for financial reporting (the Review).

1.2 As part of the Review, a detailed survey was undertaken across central and local government, to identify and evaluate costs and benefits of the current valuation regime, and test and analyse prospective alternative asset measurement options with stakeholders. On balance, the Review found there was a case for change. This Consultation Paper contains specific proposals for change, balancing the needs of users and producers of the financial information, value for money considerations and the importance of timely financial reporting.

1.3 HM Treasury have proposed an initial preferred option (see Chapter 4) which entails a differential approach to valuation by classes of asset, recognising that the costs and value (to users) of valuing assets can vary by asset class. This Consultation Paper provides a vehicle to gather stakeholder views (including from users of public sector accounts) on this proposal, and other alternative options.

1.4 The proposed changes, summarised in the table below, are targeted rather than a wholesale change, and draw on existing categorisations applied in the FReM.

Table 1.A: Proposed Changes (Option 3)

Asset Category (using existing FReM categories)	Current Measurement	Proposed Measurement
Networked assets	Depreciated replacement cost, with the exception of English, Welsh and Scottish Local Authorities which depart from the FReM, and measure networked assets at historical cost	Depreciated replacement cost
Specialised assets (PPE)	Depreciated replacement cost	Historical (deemed) cost
Non-specialised assets (PPE)	Market value in existing use	Fair value
Heritage assets	Current value like other IAS 16 assets, but where not practicable to value, non-operational heritage assets reported at historical cost	No change proposed
Social housing assets	Existing use value	No change proposed
Surplus assets	Fair value	No change proposed

Intangible assets	Market value in existing use or historical cost for low value assets or assets with short useful lives	Historical (deemed) cost

1.5 This consultation covers the whole UK public sector, which is the boundary for Whole of Government Accounts. However, the Relevant Authority for each jurisdiction within that boundary will have their own due process for proposing and approving changes to their accounting regime. This consultation does not supplant those processes. The proposed changes are published for comment only. The proposals may be modified in light of comments received through the consultation process before being formally presented to the Financial Reporting Advisory Board (FRAB) for its approval.

Structure of Consultation Paper

1.6 The Consultation Paper provides;

- a summary of the findings of the Review,
- an assessment of alternative options,
- an overview of the preferred new option,
- an assessment of asset classes, and
- proposed transition and implementation timelines.

Invitation to comment

1.7 HM Treasury invites comments on the proposed amendments to be reflected in the FReM. Responses to the questions set out in Chapter 2 would be particularly welcomed. Comments are most helpful if they:

- Respond to the question as stated
- Indicate the specific paragraph or paragraphs to which they relate
- Contain a clear rationale
- Describe any alternatives HM Treasury should consider

1.8 Comments on this Consultation Paper should be submitted in writing so as to be received by Thursday 18th May 2023. Respondents are asked to send their comments electronically to shikha.sharma@hmtreasury.gov.uk.

1.9 All responses will be published on the gov.uk website unless the respondent requests confidentiality.

1.10 HM Treasury will consider all comments received in writing by Thursday 18th May 2023. In considering the comments, HM Treasury will base its conclusions on the merits of the arguments for and against the alternative, not on the number of responses supporting each alternative.

Chapter 2

Questions

Question 1:

2.1 Do you agree with the assessment HM Treasury has presented for Option 1? If so, why? If not, why not and what alternatives do you propose?

Question 2:

2.2 Do you agree with the assessment HM Treasury has presented for Option 2? If so, why? If not, why not and what alternatives do you propose?

Question 3:

2.3 Do you agree with the assessment HM Treasury has presented for Option 3? If so, why? If not, why not and what alternatives do you propose?

Question 4:

2.4 Do you think land and buildings should be considered as their own asset category under any of the options HM Treasury has presented? If so, why? If not, why not and what alternatives do you propose?

Question 5:

2.5 Do you agree with the assessment HM Treasury has presented for Option 4a? If so, why? If not, why not and what alternatives do you propose?

Question 6:

2.6 Do you agree that Option 4a can be applied in conjunction with Option 3? If so, why? If not, why not and what alternatives do you propose?

Question 7:

2.7 Do you think there is a risk that Option 4a would not be considered true and fair, and so a pronouncement from the regulator would be necessary to address any ambiguity? If so, why? If not, why not and what alternatives do you propose?

Question 8:

2.8 Do you agree with the assessment HM Treasury has presented for Option 4b? If so, why? If not, why not and what alternatives do you propose?

Question 9:

2.9 Do you agree that Option 4b can be applied in conjunction with Option 3? If so, why? If not, why not and what alternatives do you propose?

Question 10:

2.10 Do you think there is a risk that Option 4b would not be considered true and fair, and so a pronouncement from the regulator would be necessary to address any ambiguity? If so, why? If not, why not and what alternatives do you propose?

Question 11:

2.11 Do you agree with the assessment HM Treasury has presented for other options? If so, why? If not, why not and what alternatives do you propose?

Question 12:

2.12 Do you agree, in general, with HM Treasury's proposed changes, to be reflected in FReM adaptations and interpretations to International Accounting Standard 16 *Property Plant and Equipment* (IAS 16) and adaptations to International Accounting Standard 38 *Intangibles* (IAS 38), in respect of the measurement of assets? If so, why? If not, why not and what alternatives do you propose?

Question 13:

2.13 Do you agree with the proposed measurement basis for networked assets? If so, why? If not, why not and what alternatives do you propose?

Question 14:

2.14 Do you agree with the HM Treasury definition of specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

Question 15:

2.15 Do you agree with the proposed measurement basis for specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

Question 16:

2.16 Do you agree it could be suitable for the starting point for valuation of specialised assets to be initial historical cost, but if this information is not available, then measure at historical deemed cost? If so, why? If not, why not?

Question 17:

2.17 Do you agree with the HM Treasury definition of non-specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

Question 18:

2.18 Do you agree with the proposed measurement basis for non-specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

Question 19:

2.19 Do you agree with the proposed measurement basis for operational and non-operational heritage assets? If so, why? If not, why not and what alternatives do you propose?

Question 20:

2.20 Do you agree with the proposed measurement basis for social housing assets? If so, why? If not, why not and what alternatives do you propose?

Question 21:

2.21 Do you agree with the proposed measurement basis for surplus assets? If so, why? If not, why not and what alternatives do you propose?

Question 22:

2.22 Do you agree with the proposed measurement basis for intangible assets? If so, why? If not, why not and what alternatives do you propose?

Question 23:

2.23 Do you think the proposed changes of the preferred new option will improve the financial reporting for users of the account? If so, why? If not, why not and what alternatives do you propose?

Question 24:

2.24 Overall, do you agree with the sub-classes of assets HM Treasury has identified as in scope of IAS 16 for the purposes of the differential regime proposed? If so, why? If not, why not and what alternatives do you propose?

Question 25:

2.25 Are there any areas of ambiguity in the proposal that you think will require further guidance? If so, what areas would require further guidance?

Question 26:

2.26 Do you agree with the proposed effective date of financial year 2025-26 for the changes? If so, why? If not, do you think the proposed effective date should be accelerated to financial year 2024-25? If so, why?

Question 27:

2.27 Do you agree with the proposed timeline for implementation? If so, why? If not, why not and what alternatives do you propose?

Question 28:

2.28 Do you agree with the transition approach for the proposed amendments to the FReM? If so, why? If not, why not and what alternatives do you propose?

Question 29:

2.29 Are there any areas of further guidance required for transition? If so, what areas would require further guidance?

Question 30:

2.30 Are there any other areas not covered by the questions which you would like to comment on? Please explain any comments, including providing alternatives HM Treasury should consider.

Chapter 3

Summary of Thematic Review (the Review)

3.1 This chapter sets out a summary of the Review. The full Review will be published in due course, but this summary has been provided to expedite the consultation process on proposed changes, and to provide context for potential respondents to the consultation.

Introduction

3.2 The Review identified and evaluated alternative valuation options that have the potential to align to the objectives of government financial reporting and the views of key stakeholder groups. In accordance with the Financial Reporting Manual ("FReM"), the Code of Practice on Local Authority Accounting, and the Department of Health Group Accounting Manual ("GAM"), certain classes of non-investment assets within the scope of IAS 16 *(Property, Plant and Equipment)* and IAS 38 *(Intangibles)* – subsequent to initial recognition – are currently valued at current value in existing use ("Current Value"), at a minimum of every five years. These accounting requirements are collectively referred to as the "Current Regime". In the FReM, indexation or desktop valuations are required to be conducted in between these periods to ensure asset values are not materially misstated.

3.3 The FReM, the Code, and the GAM effectively adapt reporting under International Financial Reporting Standards ("IFRS") by removing the option of measuring non-investment assets using a historical cost model. The FReM, the Code and the GAM require the determination of Current Value based on either market value in existing use ("EUV") for non-specialised assets or depreciated replacement cost ("DRC") on a modern equivalent asset basis for specialised assets (these valuation requirements are collectively referred to as "Current Valuation").It is worth noting that, the Code allows for DRC to also be used where there is no market and/or the asset is specialised.

3.4 In the FReM, each class of asset has a different current valuation basis based on the nature and intended use. For each case it is intended to reflect the current equivalent cost of consuming the economic benefits of the assets.

3.5 Preparers of the financial statements, including within local government, experience varying degrees of challenge when applying the Current Regime and there is an ongoing debate on whether the Current Valuation provides sufficiently useful information either operationally or to external users of the financial statements. Key challenges experienced by preparers of the financial statements include time and expenses incurred by engaging with external parties to provide valuation services and efforts involved in the audit process of such valuations.

3.6 This Review contributes to HM Treasury's commitment to supporting the Department of Levelling Up, Housing and Communities (DLUHC) as they take steps to address the underlying issues in local authority reporting and audit in their package of measures announced in December 2021.[1]

[1] https://www.gov.uk/guidance/measures-to-improve-local-audit-delays

Thematic Review: Scope and Approach

3.7 The scope of work undertaken during the Review included qualitative cost benefit analysis and a quantitative cost analysis of the Current Regime. The approach was to establish whether there was a case for change relating to the Current Regime and identify and analyse the potential implications of alternative options. This approach comprised of performing the following activities:

- A qualitative cost and benefit analysis of the Current Regime to understand the advantages, current or prospective uses, disadvantages and cost drivers associated with the Current Regime. This was facilitated through structured interviews with a group of key stakeholders based on analysis across the public sector non-investment asset population and composition.

- A survey was then launched across 828 public sector entities to gather quantifiable data on the benefits and challenges faced, views on potential alternative options as well as quantitative information on costs associated with the Current Regime which supported a cost quantification exercise.

- An evaluation of advantages and disadvantages of alternative options to the current regime, identification of potential mitigations for disadvantages and an assessment of the implications of making the changes, including relevant implementation considerations.

3.8 The survey responses were analysed together with the themes arising from the qualitative interviews, the results of which are summarised below.

Thematic Review: Findings and conclusions

3.9 The Review found that elements of the Current Regime are costly relative to their benefits, and the outlook is the costs will continue to rise significantly. The Review found the estimated financial cost of the Current Regime is in the region of circa £50m per year (i.e., external valuations, preparer and auditor costs per the table below). More than half of that cost is from external valuations, and around 15% are auditing costs. The cost burden was felt most acutely in English local authorities. Relative to the value of assets in scope, the costs of the Current Regime for networked assets (at least highways and the rail network) appear less costly.

3.10 The Review did not estimate the changing costs of the Current Regime over time, but there was a widespread view from the stakeholders consulted that the use of external valuations has been growing over time, and a reason for that increase is changes in the audit regime, as the financial reporting regime in this area has remained static for many years. In the *Major Local Audits: Audit Quality Inspection* (October 2022) conducted by the Financial Reporting Council (FRC), they state that accurate valuation of property provides users of the financial statements with assurance over a body's stewardship of public money and can assist users in holding bodies accountable for the decisions made. The FRC recognise that valuation is complex and auditors should evaluate and challenge those assumptions which could have material effect on valuations. Auditors are expected to obtain appropriate audit evidence that material items are valued appropriately.[2]

3.11 More broadly the Review found a strong consensus that the Current Regime was considered burdensome, and the Review found that the work associated with reporting audited asset valuations was a contributory factor in the timeliness of reporting. There was also a broad recognition that timeliness is an important characteristic of high-quality financial reporting.

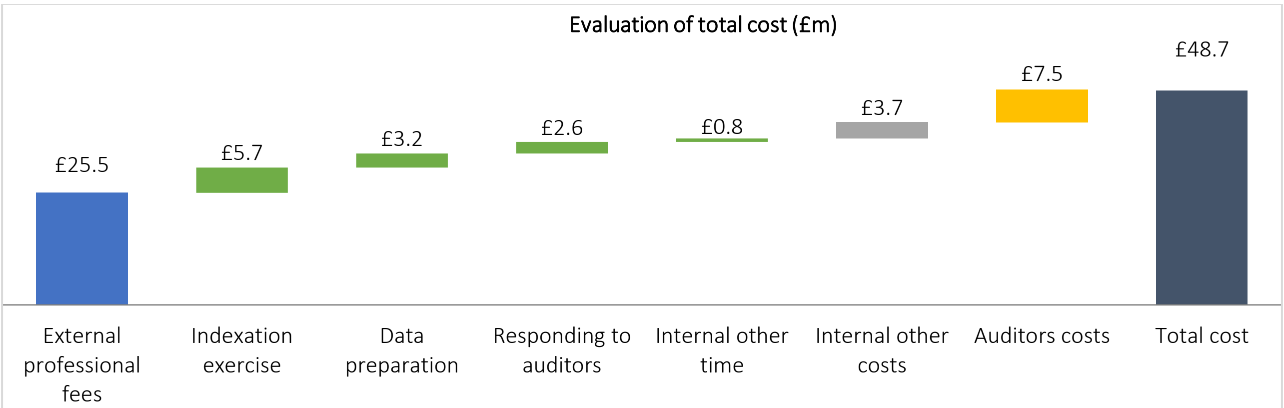
3.12 The Review considered the views of users, preparers and auditors.[3]

3.13 The Review found that the uses of the financial information provided by the Current Regime have been limited. Survey respondents were asked to consider uses of the information by both themselves and those outside their organisation (to the best of their knowledge). It is worth noting that internal uses appear stronger in the health sector. Discussions with stakeholders suggest this is predominantly a second order effect arising from their use in the regimes that underpin some financial flows within the DHSC Group. For example, Public Dividend Capital dividends flows are based on net asset values, and therefore PDC dividend payers need to consider the net asset implications of their decisions.

3.14 The professional valuation community indicated there could be unrealised asset management benefits from the valuations undertaken, while in practice preparers noted a distinction in processes between asset management and financial reporting, even where they may draw upon the same data inputs. The Review also found that valuation of specialised assets (which, by definition are rarely sold in the market) is more prone to being assumption driven, and the contestability of assumptions affects the audit process.

3.15 The Review concluded that on balance there was a case for change.

Table 3.A: Evaluation of total cost of Current Regime



[2] https://www.frc.org.uk/getattachment/aeb9149f-7bf9-45f2-802d-ca7b055b457e/Major-Local-Audits.pdf

[3] HM Treasury intend to work closely with relevant authorities to further engage with primary users in order to obtain feedback to this Consultation Paper

Alternative options

3.16 During interviews with key stakeholders, alternative options that could still potentially meet the objectives of financial reporting were identified. These alternative options were explored further with preparers as part of the survey, and their appetite for change was evaluated.

3.17 Consistent with interviews with preparers, the survey results demonstrated strong support for changing the current accounting framework across the majority of the government bodies, users and other stakeholders who participated in the survey.

3.18 The broad conclusion of the Review was that a differential policy by asset class was the lead option. This is Option 3 presented below. Option 3 is the basis for the proposed changes set out in Chapter 4 of this Consultation Paper.

Alternative options analysis

3.19 Alternative options were identified as part of the scoping phase of the Review to consider whether another, more appropriate, valuation regime exists as compared to the Current Regime.

3.20 The Conceptual Framework for Financial Reporting ("The Framework") allows the use of two measurement bases – historical cost and current value. The Framework asserts that both bases can provide predictive and confirmatory value to users, but one basis might provide more useful information than the other under different circumstances. As such, the Framework does not favour one measurement basis over the other.

3.21 The Framework describes several factors that shall be considered when determining measurement bases for assets and liabilities, which are discussed below:

Relevance

3.22 The Framework states that the relevance of information necessary to determine the measurement basis of an asset (or liability) is affected by:

- the characteristics of the asset (or liability); and
- how that asset (or liability) contributes to future cash flows (for example whether it produces future cash flows directly or is used in combination to produce cash flows indirectly).

3.23 Characteristics of the asset (or liability) depend on whether the value is sensitive to market factors or other risks which cause a difference between its historical cost and fair value.

3.24 The Framework states that different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability. Therefore, each option presented below considers the possible implications and outcomes as they are dependent on various factors. Some hold the view that current values will always be more relevant to users than historical cost. This argument is strongest where the asset is held to generate future cash flows.

Current values can provide predictive or confirmatory value to users in respect of future cash flows. Where an asset is held for its service potential, rather than to generate future cash flows, the situation can be more nuanced, in particular where there are limited market-based inputs to support a valuation (although there is still an argument that current valuation is relevant, for example, to reflect the current cost of the consumption of that service potential).

Faithful representation

3.25 Faithful representation means representation of the substance of an economic occurrence instead of representation of its legal form only. Faithful representation seeks to maximise the underlying characteristics of completeness, neutrality, and freedom from error.

3.26 Using different measurement bases for assets (and liabilities) that are related in some way can create an accounting mismatch. Financial statements that contain accounting mismatches may misrepresent some aspects of the entity's financial position and financial performance. As a result, the same measurement basis for related assets and liabilities usually provides users of financial statements with information that is more useful than the information that would result from using different measurement bases.

3.27 In instances where an input cannot be determined directly by observing prices in an active market, inputs can instead be estimated which may cause uncertainty. In broad terms, there has been a growing use of estimation in financial statements in recent years. This has been pursued with the aim of providing financial information that is more relevant to the needs of users. However, where the level of measurement uncertainty associated with a particular measurement basis is very significant, it may be questionable whether the estimate would provide sufficient faithful representation. In such cases, the most useful information may be the uncertain estimate accompanied by a description of the estimate and an explanation of the uncertainties that affect it.[4]

Enhancing qualitative characteristics and the cost constraint

3.28 Comparability, verifiability, timeliness, and understandability are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. Cost is a pervasive constraint on the information that can be provided by general purpose financial reporting. Reporting such information imposes costs and those costs should be justified by the benefits of reporting that information. These characteristics and costs are relevant to the selection of an appropriate measurement base.

3.29 Consistently using the same measurement bases for the same items, such as from period to period or across entities, helps make financial statements more comparable.

3.30 A change in measurement basis can lead to financial statements becoming less understandable. However, a change is justified if other factors outweigh the reduced understandability, such as if the change results in more relevant information.

[4] https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2021/issued/part-a/conceptual-framework-for-financial-reporting.pdf

3.31 Information and measures that can be independently corroborated, either directly (i.e. observing prices) or indirectly (i.e. checking inputs to a model), increases the verifiability of measurement bases that are used.

3.32 The factors above underpinned discussions with key stakeholders on the possible alternatives to the Current Regime, including focused consideration of the 4 alternative options set out below.

Option 1 – Historical deemed cost model

3.33 This option considers transition to the historical cost model by all public sector bodies for all classes of assets. It is likely to be impracticable to recreate the historical cost information and apply the change retrospectively; therefore, it is proposed that the transition value is assumed to equal the current value of the asset at the transition date (i.e., the deemed cost). Subsequent depreciation, amortisation and impairment is based on the deemed cost and starts from the date of adoption of changes.

3.34 The main benefits of this option are that the historical cost model is generally well understood and is less subjective than other options. It is easy to verify as a reliable measurement basis. Therefore, it has the potential to be less costly to maintain compared to the existing valuation regime.

3.35 The main challenges with this option are that the disparity between the carrying value under the historical cost model and current values can be significant due to annual price changes. Therefore, the reporting information over time will become less useful and relevant (per the factors of The Framework) to users. Users who are seeking to evaluate intergenerational fairness by using financial statement asset values, may favour reporting assets at current valuation. Historical cost valuation results in limited data points that may hinder transparency over resources being consumed. Similar assets, which have been acquired at different times, will be reported at different values in the financial statements. This may also limit the ability of users of financial statements to assess, corroborate or challenge management's stewardship of resources.

Question 1: Do you agree with the assessment HM Treasury has presented for Option 1? If so, why? If not, why not and what alternatives do you propose?

Option 2 – Revaluation model: fair value for all non-investment assets in accordance with IFRS

3.36 This option considers transition to a revaluation model where each asset is carried at fair value at the date of revaluation (less subsequent deprecation and impairment). The revaluation model would be applied prospectively in line with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* ("IAS 8") requirements. Under this option all non-investment assets (i.e., those in the scope of IAS 16 *Property Plant and Equipment* and IAS 38 *Intangibles*) would be measured at fair value.[5]

[5] The International Public Sector Accounting Standards Board (IPSASB) has released four exposure drafts (EDs) proposing changes in the measurement of assets and liabilities in financial statements. ED 78 relates

3.37 The main benefits of this option are that fair value may provide more relevant information to users of financial statements, as it is determined from the market participants' perspective and considers the highest and best use of the asset. In many cases it could result in more reliable values, subject to sufficient comparative market data being observable as at the valuation date. Additionally, the fair value of consumption of service potential or the fair value for assets under government stewardship may be very relevant to users of the accounts.

3.38 The main challenges with this option are that:

a. the constraints that typically apply with respect to disposing or changing the current use of non-investment assets in the public sector may lead this option to be less relevant. Such assets are often continuously held to deliver public services (they are held for their service potential), with limited observable market comparators. However, it is worth noting that this is not applicable to all asset classes;

b. additional time and effort may be required to identify the most advantageous market, determine highest and best uses of the asset and apply appropriate valuation techniques, which could result in additional costs that may potentially outweigh the benefits of the measurement basis.

3.39 Fair value measurement is, however, a more widely used and established valuation practice (compared to Existing Use Value) in the valuation community. Over time, fair value may result in increased comparability with private sector entities.

Question 2: Do you agree with the assessment HM Treasury has presented for Option 2? If so, why? If not, why not and what alternatives do you propose?

Option 3 – Refinement of classes of non-investment assets with valuation method based on asset class

3.40 This option considers a reassessment of distinct asset classes for financial reporting purposes, and the application of a separate measurement basis for each class of assets, in accordance with IAS 1 *Presentation of Financial Statements*, paragraph 59. This enables a differentiation of the valuation approach depending on the nature of the assets, to realise the maximum financial reporting benefits whilst minimising the associated costs. The lead option being consulted on in Chapter 4 uses asset categories already used in the FReM under the Current Regime, but alternative categorisation is also possible. For example, an option to revalue land and buildings only and not other asset classes. The advantages and disadvantages of the individual measurement bases set out in Option 1 and Option 2 are relevant to the choice of measurement base for each class. It is worth noting that the Code already recognises 'other land and buildings' as an individual class of PPE. This class should be measured at current value – where

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to PPE and proposes to introduce a public sector specific measurement basis - current operational value. Similar to currently effective IPSASs, entities will have an accounting policy option to opt for cost or revaluation model. When the revaluation model is elected, a fair value or current operational values are determined depending on whether the asset is held for financial capacity or operational capacity, respectively.

there is an active market, this shall be existing use value. If there is no market-based evidence of current value, authorities may need to estimate current value using a DRC approach.

3.41 The main benefits of this option are that differentiating measurement bases by classes of asset has the potential to address many challenges raised by preparers. This is because it may allow the application of a relevant and practically achievable accounting policy without undue cost and effort. It enables the public sector to apply the optimum cost/benefit measurement basis for each type of asset class, depending on the nature and intended use of the asset.

3.42 The main challenges with this option are a) the different measurement bases by classes of assets may make aggregate measures (e.g., Property, Plant and Equipment Net Book Value) less understandable to users of financial statements; and b) this option introduces potential judgement over the categorisation of individual assets. There could also be transition costs where new line items need to be presented to comply with IAS 1 *Presentation of Financial Statements* (para 59*).* There are also the specific challenges identified above with the historical deemed cost model (paragraph 3.35) and fair value (paragraph 3.38) to consider.

3.43 A possible mitigation to these challenges would be to introduce detailed application guidance to aid the transition and categorisation of asset classes. In addition, current values could continue to be reported in either the financial statement disclosures or the unaudited section of the annual report. However, this would need to be explored further to ensure it would not reintroduce similar challenges to those that the proposed change is seeking remedy.

Question 3: Do you agree with the assessment HM Treasury has presented for Option 3? If so, why? If not, why not and what alternatives do you propose?

Question 4: Do you think land and buildings should be considered as their own asset category under any of the options HM Treasury has presented? If so, why? If not, why not and what alternatives do you propose?

Option 4 – Periodic reset to current valuation

3.44 This option seeks to achieve a more prescriptive approach to revaluation, in light of the cost-benefit argument of less frequent valuations. Option 4 could either apply to all assets or to classes of assets. The application of a differential approach by asset class is explored in Option 3, and in theory the approach in Option 4 could be applied to one or more asset classes identified under this differential approach.

3.45 There are two approaches to achieving the aims of Option 4. The first **(option 4(a))** is a periodic reset of deemed cost to current valuation. This would be an adapted historical cost model, reframing the adaptation in the FReM to revalue deemed cost quinquennially (or quinquennially with indexation). It seeks to compensate for the deteriorating relevance of the deemed historical cost approach while also constraining the need to demonstrate no material difference between the carrying value and current value at each reporting date.

3.46 The second **(option 4(b))** is to continue to apply current values (in accordance with the Current Regime) but to introduce a FReM adaptation to IFRS prescribing that revaluations shall only be undertaken quinquennially. This would be an adapted revaluation model. In practice, this seeks to obtain the same result as option 4a, with current values reset periodically and constraining the need to demonstrate no material difference between the carrying value and current value at each reporting date.

3.47 The main challenge with option 4a is that it may be in tension with the IFRS Conceptual Framework. The two different bases (historic cost and current value) are fundamentally different in nature and the IFRS Conceptual Framework does not appear to allow for a combination of the two. The Conceptual Framework states that it would be normal to select the same measurement basis for the initial measurement of an asset that will be used for its subsequent measurement.

3.48 For option 4b the main challenge is obtaining auditor confidence and assurance of asset values on a yearly basis. In particular, if a material change in asset values has not been reflected in the financial statements (because of the prescription on the frequency of revaluation), auditors may doubt whether those financial statements present a true and fair view.

3.49 Another challenge common to both options is the risk of the majority of the public sector revaluing assets at the same time, for example quinquennially from the date of transition.

3.50 A possible mitigation to these challenges may include further explanation alongside the adaptation in the FReM that sets out how prescribing (one of) these approaches would be consistent with the IFRS Conceptual Framework. In the case of option 4b, the prescription of a rolling programme of revaluation with indexation may justify a true and fair audit opinion and mitigate the audit risk presented above – but the need to demonstrate no material difference between the carrying value and current value at each reporting date could still be an issue. With regards to the periodic timing of revaluations across government, there could be phased tranches to avoid burden on preparers, valuers, and auditors.

3.51 There is a risk that the determination of whether a prescriptive valuation cycle in the FReM is consistent with a true and fair opinion is fundamentally an entity level judgement i.e., a matter of judgement to be considered on a case-by-case basis dependent on the nature of asset class and economic cycle. As such, this potentially introduces a layer of complexity and inconsistency in application across the individual components of Whole of Government Accounts and their respective auditors.

Question 5: Do you agree with the assessment HM Treasury has presented for Option 4a? If so, why? If not, why not and what alternatives do you propose?

Question 6: Do you agree that Option 4a can be applied in conjunction with Option 3? If so, why? If not, why not and what alternatives do you propose?

Question 7: Do you think there is a risk that Option 4a would not be considered true and fair, and so a pronouncement from the regulator would be necessary to address any ambiguity? If so, why? If not, why not and what alternatives do you propose?

Question 8: Do you agree with the assessment HM Treasury has presented for Option 4b? If so, why? If not, why not and what alternatives do you propose?

Question 9: Do you agree that Option 4b can be applied in conjunction with Option 3? If so, why? If not, why not and what alternatives do you propose?

Question 10: Do you think there is a risk that Option 4b would not be considered true and fair, and so a pronouncement from the regulator would be necessary to address any ambiguity? If so, why? If not, why not and what alternatives do you propose?

Other options

3.52 Other options that were discussed but discounted include moving to a simplified revaluation model or permitting a reduced frequency of revaluations under the Current Regime.

3.53 Although such options may be less complex and require less implementation effort, they are likely to result in significant departure from IFRS requirements. Therefore, these options are unlikely to be an acceptable approach to standard setters, regulators, and auditors.

Question 11: Do you agree with the assessment HM Treasury has presented for other options? If so, why? If not, why not and what alternatives do you propose?

Chapter 4

Overview of the proposed change – Option 3 (applying existing categories in the FReM)

4.1 After considering all of the options set out in Chapter 3, Option 3 (refinement of classes of non-investment assets with valuation method based on asset class) is HM Treasury's preferred option. The remainder of the Consultation Paper will set out a more detailed proposal of Option 3, including proposed measurement bases for each asset class with the aim of obtaining stakeholder feedback.

4.2 The key advantage of Option 3 is that it accommodates different measurement bases by class of assets, allowing for a more targeted approach in addressing the challenges of the Current Regime.

4.3 The classes of asset use existing categories stated in the FReM. Certain asset classes would change their measurement base from current valuation to historical (deemed) cost. Other asset classes would change from current valuation to Fair Value.

4.4 IFRS and International Public Sector Accounting Standards ("IPSAS") allow application of a cost or revaluation model by classes of assets. A class of property, plant and equipment is defined as a grouping of assets of a similar nature and use in an entity's operations.

4.5 IAS 8 states that an entity is permitted to change an accounting policy if the change results in the financial statements provides reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance, or cash flows.[6] In line with the principles of IAS 8*,* transitioning to the cost model from the revaluation model for certain classes of assets intends to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time. This transition will provide a true and fair view of the state of specific classes of assets of the reporting entity at the end of the financial year. It will allow for specific aspects of financial reporting to be presented in a way that reflects economic reality based on the class of asset and, hence, result in a true and fair view.

4.6 This proposed policy assumes transition on a deemed cost basis for assets moving to the historical cost model. For an asset measured at current valuation that changes to a cost model, the current valuation at transition will be the deemed cost. As per the Conceptual Framework, using the deemed cost as a starting point for subsequent measurement at historical cost will help provide relevant information about the asset.[7]

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[6] IAS 8.14

[7] https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2021/issued/part-a/conceptual-framework-for-financial-reporting.pdf

Question 12: Do you agree, in general, with HM Treasury's proposed changes, that will be reflected in FReM adaptations and interpretations to IAS 16 and adaptations IAS 38, in respect of the measurement of assets? If so, why? If not, why not and what alternatives do you propose?

Assessment of asset classes

4.7 The proposed accounting policy requires appropriate classification of classes of assets.

4.8 HMT propose the following classes of IAS 16 assets:

- Networked assets
- Specialised assets (PPE)
- Non-specialised assets (PPE)
- Heritage assets
- Social housing assets
- Surplus assets

4.9 There will be no sub-classification of IAS 38 assets, for remeasurement purposes.

4.10 The asset classes identified in this option apply categories already used in the FReM. Entities could continue to disclose line items within the asset categories (e.g., Land, Buildings, Plant and Machinery etc).

Networked Assets

4.11 Networked assets are a type of infrastructure asset. As per the FReM, networked assets comprise assets that form part of an integrated network servicing a significant geographical area[8].

4.12 Networked assets display some or all of the following characteristics:

- They are part of a system or network
- They are specialised in nature and do not have alternative uses
- They are immovable
- They may be subject to constraints on disposal

4.13 Examples of networked assets are road networks, sewer systems, water and power supply systems and communication networks.

4.14 The current measurement basis for networked assets is depreciated replacement cost (DRC), with the exception of English, Welsh and Scottish Local Authorities which depart from the FReM and measure networked assets at historical cost. This difference in accounting treatment results in an audit qualification in Whole of Government Accounts.

[8] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1041796/2022-23_FReM_-_Dec_21.pdf

4.15 The proposed measurement basis for networked assets is depreciated replacement cost (i.e., unchanged).

4.16 Notwithstanding that networked assets are specialised in nature, DRC remains the preferred measurement basis because:

a. challenges in the local government sector have demonstrated the potential practical drawbacks with using historical cost for this asset category[9];

b. applying Fair Value would likely lead to a DRC measurement because of the nature of the asset;

c. the Review found that where it was applied, the costs of producing the financial information relative to the asset values were comparatively low;

d. the Review also found that some key external users valued the financial information provided by reporting such economically significant infrastructure assets at valuation;

e. the distinguishing characteristics of networked assets in the public sector, such as long useful lives, complexity of componentisation and frequency of alterations support a DRC approach.

Question 13: Do you agree with the proposed measurement basis for networked assets? If so, why? If not, why not and what alternatives do you propose?

Specialised Assets (PPE)

4.17 Specialised assets (PPE) are those that are rarely, if ever, sold in the market, except by way of a sale of the business or entity of which it is part. This is due to the uniqueness arising from its specialised nature and design, its configuration, size, location or otherwise[10].

4.18 To identify a specialised asset, the following questions should be considered:

- Does it have specialised features?
- Does it include specialised adaptations?
- Does it have to be in that particular location?
- Is there any useful/relevant evidence of recent market transactions to similar types of assets? (If there is, this is an indication that it is not specialised)

4.19 Examples of specialised assets are hospitals, prisons, schools and military equipment.

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[9] An issue related to the appropriate application of component accounting requirements by Local Government were raised by auditors. Specifically, the issue related to the assessment of undepreciated cost remaining on the balance sheet for the replaced components that need to be derecognised when subsequent expenditure is added. CIPFA issued an urgent consultation on temporary changes to the Code to resolve the identified issue and propose the adoption of depreciated replacement cost measurement basis as a possible long-term solution. Stakeholders supported the temporary proposal to remove gross historical cost and accumulated depreciation disclosure requirements. Since the temporary proposal, there has been a statutory override that came into effect on 25th December 2022. The override applies until 31 March 2025. There are statutory provisions in Scotland and Wales on this issue; however, the English regulations provide that where a local authority replaces a component of an infrastructure asset, the authority has a choice of how to identify the carrying amount to be derecognised in respect of that component. This would be either nil or the carrying amount in line with accounting practices in the Code. The Regulations offer Local Authorities a choice between the two options

[10] rics-valuation--global-standards.pdf

4.20 The current measurement basis for specialised assets is depreciated replacement cost (DRC).

4.21 The proposed new measurement basis for specialised assets is historical (deemed) cost.

4.22 Conceptually DRC seeks to reflect the replacement cost of an asset's service potential. In practice, for specialised assets, the valuation can be highly assumption-driven. This can constrain the relevance of reported asset values, weakening predicative or confirmatory value. Its assumption driven nature also weakens its reliability. It can also have limited connection to the practical spending implications of replacing the asset. This is not to dismiss the value of DRC, but rather to qualify it.

4.23 Specialised assets are typically built or modified for public services and are not intended to be traded. There is no active market for specialised assets. Seeking out comparative market value inputs risks being time consuming and not cost effective, suggesting Fair Value is not the optimal approach.

4.24 Changing the measurement basis to historical (deemed) cost is preferable because;

a. the new measurement base removes complexity and cost, moving away from a valuation basis where the relevance of the financial information is more qualified and where there is a lack of market inputs;

b. this improves the reliability of the financial information reported.

Question 14: Do you agree with the HM Treasury definition of specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

Question 15: Do you agree with the with the proposed measurement basis for specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

Question 16: Do you agree it could be suitable for the starting point for valuation of specialised assets to be initial historical cost, but if this information is not available, then measure at historical deemed cost? If so, why? If not, why not?

Non-specialised Assets (PPE)

4.25 Non-specialised assets (PPE) are operational assets held for their service potential, used to deliver either front line services or back-office functions, but are non-specialised in nature. An example of non-specialised assets is office buildings.

4.26 The current measurement basis for non-specialised assets is market value in existing use.

4.27 The proposed new measurement basis is Fair Value in accordance with IFRS 13 *Fair Value Measurement*.

4.28 The case for changing the measurement basis to Fair Value is;

a. Market value in existing use (or Existing Use Value) is a measurement basis that is only used in UK public sector financial reporting. Knowledge and practical experience in its application is more limited in the valuation industry. Application of a more widely used measurement basis may support more competitive pricing for external valuations.

b. There is value to users in a measurement basis that reflects the alternative use of the asset where it could be sold in an open market – i.e. the value that a buyer is willing to pay for the asset.

c. IFRS 13 valuation techniques incorporate alternative uses and opt for observable inputs that determine the highest and best use of the asset. For non-specialised assets there is potential for the IFRS 13 Fair Value measurement to provide more relevant and reliable financial information to users.

4.29 In practice, the fair value of non-specialised land and buildings may approximate to market value in existing use; however, valuers may need to perform additional analysis to support that no other potential uses of assets would result in highest and best use value.

4.30 HM Treasury's conclusion on the measurement basis for this asset class is more tentative. There is a risk that in practice there are challenges in providing a full assessment of potential alternative uses of non-specialised assets, or that such an assessment and the associated audit become onerous. However, the valuation basis is well understood in the valuation community and the financial information may support asset management decisions, incentivise more efficient uses of assets, and support accountability and scrutiny. The new measurement basis will increase the transparency of the opportunity cost of holding public sector assets which could be sold in the market.

4.31 For clarity, this class of asset remains distinct from assets held for sale (as reported under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations),* and surplus assets as defined in the FReM. This non-specialised asset class does not infer that these assets are non-essential for public service delivery.

Question 17: Do you agree with the HM Treasury definition of non-specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

Question 18: Do you agree with the proposed measurement basis for non-specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

Heritage Assets

4.32 Heritage assets (as per the FReM) are tangible assets with historical, artistic, scientific, technological, geophysical or environmental qualities that are held and maintained principally for their contribution to knowledge and culture. Heritage assets are those assets that are intended to be preserved in trust for future generations because of their cultural, environmental or historical associations. They are held by the reporting entity in pursuit of its overall objectives in relation to the maintenance of the heritage. Non-operational assets are those that are held primarily for this purpose. Operational heritage assets are those that, in addition to being held for their characteristics as part of the nation's heritage, are also used by the reporting entity for other activities to provide other services[11].

4.33 Heritage assets comprise mainly buildings (such as Somerset House), archaeological sites, military and scientific equipment of historical importance and gallery collections and works of art.

4.34 The current measurement basis for operational heritage assets is the same as other IAS 16 assets.

4.35 The current measurement basis for non-operational heritage assets permits historical cost where it is not practical to value the asset, and where information is not available and cannot be obtained at a cost commensurate with the benefits to users of the financial statements, the assets are not recognised and instead disclosed.

4.36 HM Treasury is not proposing any change to the current measurement basis.

4.37 The Review found no significant concerns with the existing regime for those entities that hold the majority of heritage assets. In addition, many charity entities in the public sector holding significant heritage assets have elected the revaluation model under the Charities SORP, and so any change creates the risk of dual accounting regimes.

Question 19: Do you agree with the proposed measurement basis for operational and non-operational heritage assets? If so, why? If not, why not and what alternatives do you propose?

Social Housing Assets

4.38 Local authorities raise funds to finance social housing. Their housing stock is separately accounted for in the Housing Revenue Account (HRA). Social housing assets generate rental income and have a track record of sale transactions providing comparative market information.

4.39 The current measurement basis is existing use value (EUV).

4.40 HM Treasury is not proposing any change to the current measurement basis. The measurement basis for social housing is principally a matter for CIPFA/LASAAC, as public sector social housing is controlled by Local Authorities. Housing Associations are outside of the Whole of Government Account's boundary. HM Treasury will work with CIPFA/LASAAC, as the relevant authority, to consider next steps following the outcomes of the wider Review.

Question 20: Do you agree with the proposed measurement basis for social housing assets? If so, why? If not, why not and what alternatives do you propose?

[11] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1041796/2022-23_FReM_-_Dec_21.pdf

Surplus Assets

4.41 Surplus assets are assets that are not being used to deliver services, and do not meet the criteria to be classified as either investment properties or non-current assets held for sale.

4.42 The current measurement basis is fair value, in accordance with IFRS 13 *Fair Value Measurement*.

4.43 HM Treasury is not proposing any change to the current measurement basis.

Question 21: Do you agree with the proposed measurement basis for surplus assets? If so, why? If not, why not and what alternatives do you propose?

IAS 38 Intangible Assets

4.44 Intangible assets are those which fall within the scope of IAS 38. Examples of intangible assets are research and development, software and licenses.

4.45 The current measurement basis is market value in existing use or historical cost for low value assets or assets with short useful economic lives.

4.46 The proposed new measurement basis is historical (deemed) cost.

4.47 The case for changing the measurement basis is;

a. For public sector intangible assets there is typically a lack of observable market inputs for valuation purposes. The Review found limited perceived benefit from holding these assets at valuation or considering alternative uses to estimate their fair value.

b. Historical (deemed) cost is well understood and easy to verify as a reliable measurement.

Question 22: Do you agree with the proposed measurement basis for intangible assets? If so, why? If not, why not and what alternatives do you propose?

Question 23: Do you think the proposed changes of the preferred new option will improve the financial reporting for users of the accounts? If so, why? If not, why not and what alternatives do you propose?

Question 24: Overall, do you agree with the sub-classes of assets HM Treasury has identified in scope of IAS 16 for the purposes of the differential regime proposed? If so, why? If not, why not and what alternatives do you propose?

Chapter 5

Proposed guidance areas

5.1 Guidance on the proposed regime may be needed to cover implementation and transition.

5.2 Guidance on impairment of non-cash generating assets may be needed to consider the nature of public sector assets. Determining the value in use for non-cash generating assets could be approached in accordance with IPSAS 21 *(Impairment of non-cash generating assets)*.

5.3 Guidance on impairment models may be needed to consider impairment indicators and impairment reviews, in particular for specialised PPE.

5.4 Guidance on one-off transition date valuation exercises may be needed for those assets that will be measured at fair value.

5.5 Under the current HMT IFRS 16 *Leases* ("IFRS 16") application guidance, right-of-use assets are measured at either fair value or current value in existing use. Guidance on subsequent measurement of leased assets may be needed to ensure any changes to the valuation regime address application for IFRS 16.

Question 25: Are there any areas of ambiguity in the proposal that you think will require further guidance? If so, what areas would require further guidance?

Chapter 6

Transition and Implementation Plan

6.1 HM Treasury proposes to apply amendments to the FReM from 1 April 2025. The transition and implementation timetable can be found in Table 6.A.

Table 6.A: Transition and Implementation Timetable[12]	
[February 2023]	Consultation Paper for public consultation
[April 2023]	Consultation closure date
Spring 2023	Consolidate feedback from Consultation Paper responses
June 2023	FRAB meeting: consultation review and agree proposals
Summer 2023	Transition and implementation guidance preparation
Autumn 2023	Transition and implementation guidance consultation
October 2023	Consultation closure date
November 2023	FRAB meeting: consultation review and proposal of FReM amendments
December 2024	2025-26 FReM and Application Guidance published
April 2025	Beginning of first year of application

Question 26: Do you agree with the proposed effective date of financial year 2025-26 for the changes? If so, why? If not, do you think the proposed effective date should be accelerated to financial year 2024-25? If so, why?

Question 27: Do you agree with the proposed timeline for implementation? If so, why? If not, why not and what alternatives do you propose?

Question 28: Do you agree with the transition approach for the proposed amendments to the FReM? If so, why? If not, why not and what alternatives do you propose?

[12] Other relevant authorities will advise on their process for transition and implementation.

Question 29: Are there any areas of guidance required for transition? If so, what areas would require further guidance?

Other business considerations

6.2 There are a number of areas where the introduction of the proposed alternative valuation policy may impact on other business activities. These include:

- For the Department of Health and Social Care (DHSC), the impact on the calculation of the Public Dividend Capital dividend would have to be considered.
- For DHSC, and potentially other Central Government bodies, capital allocations may also be impacted as these are based on depreciation values.
- Entities may need to consider changes to budgets for the year of implementation.
- Guidance on the calculation of fees and charges may need to be updated.

Question 30: Are there any other areas not covered by the questions which you would like to comment on? Please explain any comments, including providing alternatives HM Treasury should consider.

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