HM Treasury

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

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Executive Summary

HM Treasury committed in the summer of 2022 to undertake a thematic review of the valuation of non-investment assets for financial reporting purposes in the public sector.

This is part of a wider Governmental Financial Reporting Review[1] commitment to carry out regular thematic reviews focusing on different issues in government financial reporting. This thematic review also 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.[2]

The purpose of this thematic review was to assess the current regime of asset valuation across the public sector, and to identify and evaluate the case, options, and timing for any revisions to the current approach. The review has considered the strengths and areas for improvement of the current regime, and potential developments going forwards. This document presents the results of the review.

When considering the results of the thematic review, HM Treasury, in consultation with the Financial Reporting Advisory Board (FRAB), have concluded that there is merit in exploring changes to the current public sector asset valuation regime via a formal consultation. A Consultation Paper[3] on changes to the Financial Reporting Manual (FReM) guidance on non-investment asset valuation was published in March 2023. The proposals in the Consultation Paper draw from the findings of the thematic review.

HM Treasury, FRAB and other relevant authorities will consider the results of the consultation alongside the thematic review output in determining whether any changes to the current regime should be implemented. No final decisions have been made yet in this area.

In this report:

1. Chapter 1 puts the review into context, explaining the current regime and giving some detail on the scope and timeline of the review.

2. Chapter 2 summarises the discovery phase of the review, and the initial alternative options developed as a response to that analysis.

3. Chapter 3 discusses the outcome of a survey circulated across the public sector. The purpose of the survey was to conduct an assessment of the current regime by asking respondents to use scaled scoring on the uses and limitations of the current regime and to obtain feedback on potential alternative options.

4. Chapter 4 brings together the findings and recommendations from Chapters 2-4 to give a complete summary of the next steps for Treasury.

[1] Government Financial Reporting Review
[2] Measures to improve local audit delay
[3] HMT - Thematic Review of Non-investment Asset Valuation Consultation Paper

Chapter 1

Introduction

1.1 This chapter sets out the scope of the thematic review and puts the review into context by presenting the current valuation regime of non-investment assets, followed by a timeline of the review. The current regime is outlined below.

1.2 The purpose of the thematic review was to identify and analyse any challenges of the current regime, and to identify and evaluate the benefits and uses of the financial information produced under the current regime. This, combined with an assessment of possible alternatives, helped HM Treasury to determine whether changes to the current regime should be formally consulted upon going forwards.

1.3 HM Treasury decided to launch the thematic review in part due to challenges that had been reported in relation to the current regime including, but not limited to, meeting the burden of audit requirements, and the time and expenses incurred by preparers in engaging with external parties to provide valuation services. Preparers of financial statement reported experiencing these challenges to varying degrees.

1.4 There were also questions raised as to the best use of the information which the current regime provides, both operationally and to external users of the financial statements.

1.5 As part of the thematic review, HM Treasury engaged with stakeholders across the public sector to assess the cost, benefits, and consideration of alternative options to the current regime.

Scope of review

1.6 The core scope of this review is focused on non-current assets in the Whole of Government Accounts (WGA) boundary. This primarily relates to certain classes of non-investment assets within IAS 16 (*Property, Plant and Equipment*) and IAS 38 (*Intangible Assets*). The WGA boundary covers everything that is classified by the Office for National Statistics as in the public sector, including central government departments, local authorities, devolved administrations, the NHS, academy schools and public corporations.

1.7 The review excludes assets in scope of IFRS 5 *(Assets Held for Sale)*, IAS 40 *(Investment Properties)*, IFRS 9 *(Financial Instruments)* and IFRS 16 *(Leases)*.

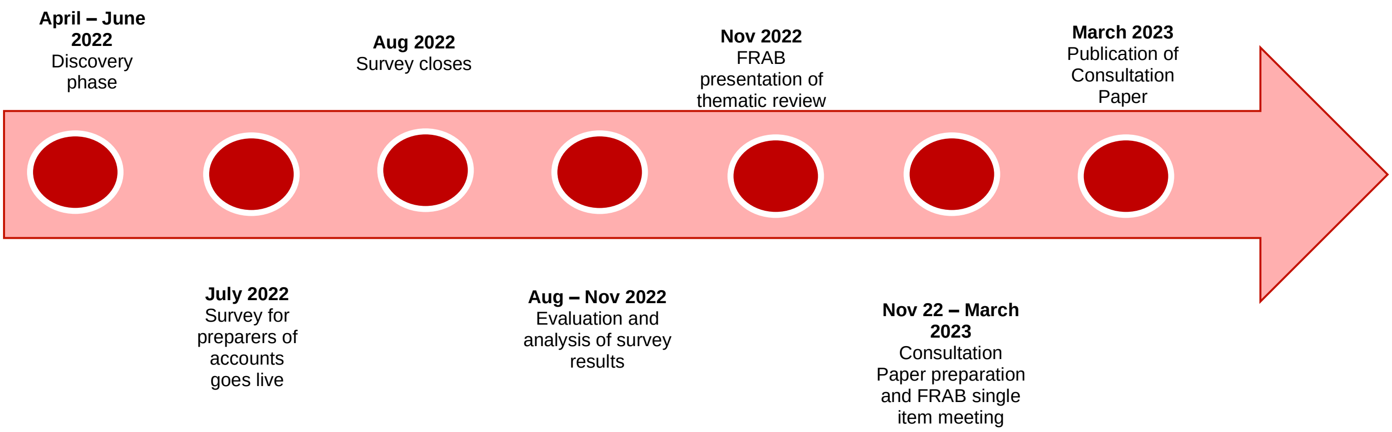
1.8 The review sought feedback from the key stakeholders impacted by the current regime, including accounts preparers, users, professional valuers, professional standard-setting bodies, and auditors.

1.9 The scope of work undertaken as part of the review was comprised of an analysis of the current regime and an analysis of alternative options. The approach taken was to establish how the current regime was functioning in practice, and to identify and analyse the potential implications of alternative options. This approach comprised of performing the following activities:

- A qualitative 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, who were identified as being particularly impacted by the current regime.
- A subsequent survey, launched across 828 public sector entities to gather data on the benefits and challenges faced under the current regime and views on potential alternative options to the current regime.
- Analysis of alternative options to the current regime. This included identifying potential mitigations for disadvantages of alternative options and an assessment of the implications of implementing those alternative options. This informed HM Treasury and FRAB's decision to formally explore making changes to the current regime via a Consultation Paper.

1.10 Engagement with stakeholders took place between April 2022 and August 2022. After evaluating and consolidating all responses, the initial results were discussed with FRAB in November 2022 and January 2023. After considering the outcomes of the thematic review, HM Treasury and FRAB agreed that there was merit in formally consulting on changes to the current regime. The related Consultation Paper on potential changes was published in March 2023.

Timeline of review



Current regime

1.11 The UK public sector follows International Financial Reporting Standards (IFRS), adapted and interpreted for the public sector context. IFRS standards provide a high-quality, internationally recognised set of accounting standards. These bring transparency, accountability, and efficiency to financial markets across the world. For the UK public sector, adherence to IFRS supports the transparency and consistency of high-quality financial reporting that:

- Is transparent for users and comparable over all periods presented
- Provides a suitable starting point for adapting and interpreting for the public sector context
- Can be generated at a cost that does not exceed the benefits to users

1.12 The IFRS Conceptual Framework includes two fundamental qualitative characteristics of useful financial information: relevance, and faithful representation. By adhering to IFRS and ensuring both characteristics are demonstrated, UK public sector financial reporting is fair, balanced and understandable.

1.13 The FReM (which covers central government bodies including departments, agencies, arm's length bodies, and academy schools), the Code of Practice on Local Authority Accounting (the Code) and the Department of Health and Social Care Group Accounting Manual (the GAM), outline how IFRS have been adapted or interpreted for the public sector. Adaptation is where a part of a standard is modified to take into account particular public sector circumstances, and interpretation is where part of a standard is explained further, so as to clarify its appropriateness for the public sector context.

1.14 As outlined above, the thematic review covers assets held at current valuation under IAS 16 and IAS 38. As per IAS 16 and IAS 38 requirements, assets should initially be measured at cost.

1.15 IAS 16 and IAS 38 permit two accounting models for subsequent measurement:

- **Cost model** – the asset is carried at cost less accumulated depreciation/amortisation and impairment

- **Revaluation model** – the asset is carried at a revalued amount, being its fair value at the date of revaluation less subsequent depreciation/amortisation and impairment, provided that fair value can be measured reliably and determined by reference to an active market

1.16 The FReM, the Code and the GAM adapt these requirements by removing the historic cost model option for subsequent measurement in the majority of cases.

1.17 Since the implementation of accruals accounting and budgeting in the late 1990s, central government bodies have been required to measure operational assets at current value in existing use or fair value at the reporting date (i.e., the option given in IAS 16 to measure at cost was withdrawn). This is so that the measurement of assets held by central government reflected those assets' service potential or operational capacity.

1.18 The adaptations in the FReM and the GAM for IAS 16 and IAS 38 have existed since 2009-10, when the government started to apply IFRS as interpreted and adapted for the public sector. For central government, the FReM and GAM state that PPE which are held for their service potential 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 Existing Use Value. 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 (i.e., depreciated replacement cost).

1.19 Adaptations to IAS 16 and IAS 38 for local government, as per the Code, are consistent with central government except for the application of the current value measurement for infrastructure assets and community assets.

1.20 Since the early 1990s, the Code has required separate presentation of infrastructure and community assets on the balance sheet and permitted the cost model to remain an option for both types of assets. For infrastructure assets this was as a practical expedient due to the significant practical difficulties and resource costs in developing information on local authority highways networks. There was also consideration of the fact that expenditure for infrastructure assets is only recoverable by continued use of the asset created.

1.21 The Code defines community assets as assets that an authority intends to hold in perpetuity, that have no determinable useful life and that may, in addition, have restrictions on their disposal.

1.22 Table 1.A set outs a summary of the current regime for existing asset classes applied in the FReM, the GAM and the Code.

Table 1.A Current Valuation Regime

Asset Category	**Current Measurement as per the FReM and the GAM**	**Current Measurement as per the Code**
Infrastructure Assets	Depreciated replacement cost	Historical cost[4]
Specialised assets (PPE)	Depreciated replacement cost	Depreciated replacement cost
Non-specialised assets (PPE)	Market value in existing use *defined as Existing Use Value (EUV)*	Market value in existing use *defined as Existing Use Value (EUV)*
Heritage assets	Current value like other IAS 16 assets *where not practicable to value, non-operational heritage assets to be reported at historical cost*	Current value like other IAS 16 assets *where not practicable to value, non-operational heritage assets to be reported at historical cost*
Social housing assets	Not disclosed in the FReM/GAM	Market value in existing use – social housing
Surplus assets	Fair value	Fair value

[4] Local authorities which are not in Scotland have been provided with a temporary relief for certain reporting on infrastructure assets, so that local authorities are not required to report the gross book value and accumulated depreciation for infrastructure assets. Where a local authority chooses to apply this temporary relief, the Code requires that additional information is provided to explain the authority's rationale for this decision. This temporary relief does not apply to local authorities in Scotland.

Intangible assets	Market value in existing use or historical cost for low value assets or assets with short useful lives[5]	Fair value where an active market exists[6]
Community assets	Not disclosed in the FReM/GAM	Historical cost *unless the authority elects to use current value*

Key terms for current regime

1.23 **IAS 16 Property Plant and Equipment (PPE)** – outlines the accounting treatment for PPE. Items of PPE should be recognised as assets where it is probable that:

- the future economic benefits associated with the asset will flow to the entity
- the cost of the asset can be measured reliably

1.24 **IAS 38 Intangible Assets** – outlines the accounting requirements for intangible assets. These are identifiable non-monetary assets without physical substance. An intangible asset is identifiable when it is:

- Separable (capable of being separated and sold, transferred, licensed, rented, or exchanged)
- Arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations

1.25 **Depreciated Replacement Cost (DRC)** – this is the current cost of replacing an asset with its modern equivalent asset, less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

1.26 **Existing Use Value (EUV)** – the estimated amount for which a property should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion, assuming that the buyer is granted vacant possession of all parts of the asset required by the business, and disregarding potential alternative uses and any other characteristics of the asset that would cause its market value to differ from that needed to replace the remaining service potential at least cost.[7] This is the market value for existing use of the asset, i.e., the price it can be sold for on the open market with the assumption that it will only be used for the existing use for the foreseeable future.

1.27 **Historical Cost –** this is the original cost of the asset when acquired.

[5] 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.

[6] Where no active market exists, assets are carried at cost less any accumulated amortisation and any accumulated impairment loss.

[7] RICS Valuation – Global Standards: UK national supplement

Chapter 2

Evaluation of current regime - discovery phase and stakeholder interviews

2.1 This chapter sets out the discovery phase of the thematic review, and provides a summary of stakeholder interviews on the current regime. This chapter draws out the strengths and areas for improvement of the current regime, followed by a discussion on alternative valuation options.

Discovery phase

2.2 As part of the discovery phase of the thematic review, annual reports and accounts across the public sector were reviewed to understand the application of accounting policies, the frequency of valuations and any disclosed estimation uncertainties and costs.

2.3 The WGA was also reviewed to understand the composition of non-investment assets across the public sector and to identify significant contributors to the overall asset total in the WGA.

2.4 Research and analysis were also conducted of accounting policies selected by the governments in other countries and comparable non-public sector entities in the UK. In summary, Canada and the USA prescribe the cost model for local government non-investment assets, whilst the EU currently follows the revaluation model, basing its measurement requirements on the International Public Sector Accounting Standards (IPSAS). Australia and New Zealand measure non-investment assets at cost initially. Subsequent measurement is specified by asset class, with the majority of asset classes measured at fair value every five years. The revalued amount is based on the best and highest use of the asset.

Stakeholder interviews

2.5 Initial scoping interviews were conducted with key stakeholders to understand the advantages and disadvantages of the current regime, drivers of the costs associated with the current regime and potential alternative options.

2.6 Key stakeholders participating in these interviews included preparers, users, auditors, valuers, and other interested parties (such as standard-setting authorities).

2.7 From the stakeholder interviews, a qualitative assessment of the advantages and disadvantages of the current regime was undertaken. This section summarises the main themes from the stakeholder interviews, organised by strengths and areas of improvement for the current regime, with an overall summary of the main themes of the interviews.

Strengths of the current regime

Strategic decision-making processes

2.8 Preparers recognised that asset valuation information received from the current regime can generally be used to support strategic decision-making processes. Some preparers indicated that valuation reports can feed into budgeting processes or inform further investment/divestment decisions.

2.9 Valuers argued that valuation reports could be used to provide useful information to preparers to assess the efficiency of the uses of assets. A small number of preparers agreed with this point and noted their use of valuation information in decision-making and asset management more generally, such as replacement decisions.

Asset management and stewardship

2.10 Preparers also reported that valuation information produced by the current regime could be leveraged to evaluate the level of stewardship and asset management effectively.

2.11 Other stakeholders, from the user and audit community, concurred that valuation information produced by the current regime could be useful to understand the cost of delivering public services and to evaluate stewardship and asset management. The measurement of non-investment assets at current value could help to evaluate the service potential or operational capacity of assets used to deliver goods and services.

2.12 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.

Alternative uses of valuation information

2.13 Respondents did note alternative uses of asset valuation information produced by the current regime for regulatory purposes. For example, in the health sector, Public Dividend Capital (PDC) dividends flows are based on net asset values, and therefore PDC dividend payers need to consider the net asset implications of their decisions.

2.14 The ONS noted that there is a growing interest in using revalued amounts in the determination of public sector statistical aggregates. There is also an appetite from the OBR to use current valuation in the future, as it recognises that this data is arguably more relevant than the ONS-published information in the National Accounts.

2.15 It has also been noted that other users consider valuation information to determine lease terms for properties transferred to their management remit. The Chartered Institute of Public Finance and Accountancy (CIPFA) indicated that one of the objectives of valuations is to support evaluation of intergenerational equity fairness by providing transparency over the resources consumed.

Financial reporting practices

2.16 In terms of audit, central government respondents generally reported that auditors are familiar with valuation processes, methods and assumptions made as they are well-established processes and are normally consistent with previous periods.

Areas for improvement of the current regime

Limitations in alternative uses of valuation information

2.17 Despite preparers recognising that asset valuation information can be used to support strategic decision-making processes, they noted that there are only limited circumstances where they would leverage valuation data in decision making processes at present. This is because the current regime does not always reflect the most relevant information that would be useful in strategic decision-making. This is partly driven by the fact the current regime does not always consider the highest and best use value and so may not provide useful information to support strategic economic decisions.

2.18 Although there is an alternative use of asset valuation information in the health sector, generally, preparers confirmed they are not aware of non-investment asset valuation information being used for other purposes (except as discussed in the 'strengths of the current regime' section above).

2.19 Although preparers from central government noted that valuation information can be leveraged to evaluate the level of stewardship and asset management effectively in theory, they indicated that in practice, systemic changes would be required to incentivise the public sector in using valuation information for non-financial reporting purposes.

2.20 Local government stakeholders specifically also reported that there is currently no stewardship reporting in place relating to non-investment assets. This is reporting that summarises an organisation's financial performance and stewardship approach, which would allow an evaluation of effective use of assets and could act as an incentive to use valuation information for non-financial reporting purposes. Stakeholders echoed reflections from central government that there is currently a lack of incentive to produce such information.

Judgement and estimation uncertainty to meet requirements

2.21 Preparers stated they need to allocate a considerable amount of time and resource to valuation processes to meet the requirements of the current regime. Such processes require detailed information including the asset's specialised features, purpose, location, measurements, and cost information. Valuers noted that there is a lack of consistency in the quality of data provided across the public sector, which can result in more work for valuers and auditors.

2.22 Preparers found the measurement of certain types of assets – namely specialised assets – requires significant levels of professional judgement and assumptions, which may result in the valuation information having more limited use. This is exacerbated by the fact that certain specialised assets are unique and rarely traded in the public sector;

therefore, valuations rely on significant unobservable inputs or expert judgement when making assumptions. Comparable assets are also not available in the market which adds to the higher levels of estimation uncertainty in determining values of non-investment assets in the public sector.

2.23 It was noted that supporting the use of appropriate indices and justifying the non-significance of indexation fluctuations between periods have recently become more challenging for preparers.

2.24 Users recognised that significant levels of judgement are involved in asset valuation; however, from their perspective, they believe that such levels of estimation are acceptable and do not significantly impact the usefulness of the valuation information.

Inconsistency in accounting policy between central government and local government

2.25 The inconsistency in the accounting policy for infrastructure assets in the Code compared to the FReM was noted by central government and local government respondents. Users acknowledged that consideration of the intended use of the assets in determining the measurement base is important. Stakeholders noted that inconsistent measurements may impact the usefulness of the Whole of Government Accounts (WGA).

Audit concerns

2.26 Local government respondents raised significant concerns that auditors spend disproportionate time on auditing non-investment asset valuations and use a relatively low materiality threshold compared to the asset values (as materiality is typically based on revenue expenditure). They argued that the focus of users of the financial statements is on expenditure and that very few decisions are made based on the non-investment asset value. Therefore, whilst they understand the focus due to the relevant auditing standards and regulatory requirements, many preparers felt that the auditors' heightened focus on such valuations leads to undue cost and effort.

2.27 Auditors noted that non-investment asset valuations are often treated as significant risks under ISA 315 (*Identifying and Addressing the Risks of Material Misstatement*) and that this, combined with the new requirements of ISA 540 (*Auditing Accounting Estimates and Related Disclosures – revised in 2018*), has led to a significant increase in the amount of detailed substantive testing undertaken on these balances.[8] Auditors are using internal and external subject matter experts to assess the reasonableness of the valuations prepared by preparers. However, auditors have noted that internal and external valuation reports are noticeably different at times.

[8] (FRC - Major-Local-Audits) With regards to auditing requirements, the Financial Reporting Council (FRC) has acknowledged the complexity of asset valuations. In the *Major Local Audits: Audit Quality Inspection* (October 2022), the FRC report 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 valuations are 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.

Alternative option development

2.28 The stakeholder interviews demonstrated that preparers, users and other relevant stakeholders were not fully content with the current regime and there was support for further consideration as to how the current regime could be improved.

2.29 In response to the stakeholder interview feedback, HMT identified four alternative options. HM Treasury kept a number of different principles in mind in the development of alternative options. They considered that it would only be beneficial to make revisions to the current regime if there was a viable alternative to move towards. The impact of any revisions should seek to address the disadvantages of the current regime as well as seek to maintain or improve valuation information's usefulness generally.

2.30 HM Treasury determined any amendments to the current regime would require a balanced approach, which included recognising the current and future uses of financial valuation information and the challenges faced in the context of the current regime.

2.31 Alternative valuation options should continue to meet the purposes of government financial reporting. As outlined by the Public Accounts and Constitutional Affairs Committee and considered as part of the Government Financial Reporting Review[9], the purposes of government financial reporting are:

- To maintain and ensure parliamentary control of government spending, enabling, in particular, Parliament to hold the Government accountable for its spending.
- To enable the public and researchers (both in civil society and Parliament) to understand and consider the value for money offered by public spending, so that they can make decisions about the effectiveness, efficiency and economy of particular policies or programmes.
- To provide a credible and accurate record which can be relied upon.
- To provide managers inside departments (including both ministers and civil servants) with the information they require to run the departments and their agencies efficiently and effectively.

2.32 Additionally, the User Preparer Advisory Group (UPAG) was consulted on the preliminary findings of the thematic review and asked which principles should be used when identifying alternative options. UPAG emphasised the importance of the views of users, and consideration of conceptual principles, like intergenerational fairness, when identifying alternative options.

2.33 The following initial alternative options were identified as a result of the qualitative discussions and were based on the principles outlined above:

1. Historical/deemed cost model in accordance with IFRS
2. Revaluation model for all non-investment assets in accordance with IFRS
3. Differential regime: Refinement of classes of non-investment assets and application of measurement base based on class

[9] Government Financial Reporting Review

4. No changes to the current regime

Summary

2.34 Strengths and areas for improvement of the current regime were identified from the stakeholder interviews.

2.35 In summary, three main themes were noted as benefits of the current regime. These centred around the potential for valuation information to be used for strategic decision-making processes; asset management and stewardship; and possible alternative uses.

2.36 Key themes also arose from the limitations of the current regime which centred around the drawbacks of using valuation information for alternative purposes, the level of judgement and estimation uncertainty, inconsistency in infrastructure assets accounting policy and general audit concerns.

2.37 After considering all the strengths and areas for improvement, alternative valuation options were identified. These were developed using the governmental financial reporting objectives and more specific principles (see Alternative option development section) and aimed to address the benefits and challenges of the current regime.

2.38 As part of the next stage, the alternative valuation options were tested with stakeholders using a survey.

Chapter 3
Evaluation of current regime – survey

3.1 Following the interviews described in Chapter 2, a survey was published across the public sector to conduct a quantitative assessment of the current regime. This chapter describes the survey and summarises its main themes.

3.2 The survey questionnaire was distributed to 828 entities across the public sector. This included central government bodies, local government bodies, devolved administrations and NHS trusts. A total of 161 entities from all of these backgrounds responded to the survey.

3.3 From the responses received, asset coverage ranging from 21% of total English local authorities assets to 99% of total central government assets was achieved.

3.4 It is worth noting that by the voluntary nature of the survey, the responses cannot be perfectly representative of the public sector as a whole, and the quantitative information received from the survey did not intend to be a statistical analysis of the current regime.

3.5 The survey asked respondents to evaluate the extent to which valuations of non-investment assets for their organisation/entity concurred with the strengths and areas for improvement of the current regime discussed in Chapter 2. This was on a scaled option of: strongly disagree, disagree, neither agree nor disagree, agree, and strongly agree.

3.6 The survey also asked respondents for feedback on the alternative accounting policy options discussed in Chapter 2, using a similar scaled scoring system. The scaled scoring system allowed a quantitative measurement to be applied to responses. Finally, the survey asked for limited quantitative information on the resource spent by preparers to comply with the current regime. This included respondents providing time and cost estimations based on the best available data for the last audited year-end. Due to the level of uncertainty, all data was considered indicative, subject to limitations and depended on the accuracy of data sources that have not been verified.

Findings and observations from the survey

Uses of the current regime

3.7 A small number of respondents noted the use of valuation information under the current regime in strategic decision-making processes; however, the majority of respondents acknowledged that the primary use of valuations of non-investment assets is for statutory financial reporting purposes.

3.8 It is worth noting that alternative internal uses appear slightly stronger in the health sector. Over a quarter of NHS Trusts respondents either confirmed the use of valuation information in decision making processes such as investment and divestment, or other strategic decisions related to assets. A minority of NHS Trusts indicated use of valuation information for insurance purposes.

3.9 The survey showed central government entities mostly carried out quinquennial valuations whereas NHS and local authorities tend to perform valuations on an annual or rolling programme basis.

Limitations of the current regime

3.10 The majority of respondents reported that there is a limited use of valuation data produced under the current regime. As discussed in the qualitative evaluation of the current regime, respondents noted that systemic changes would be required to incentivise the public sector in using valuation information for non-financial reporting purposes. This could include changes that would be required across public sector policies to link valuation information to other policy requirements.

3.11 There was also a general consensus across responses that additional resources would be required to use the data generated by the current regime for non-financial reporting purposes.

3.12 The majority of respondents agreed that it is time-consuming and costly to prepare valuations under the current regime. One of the identified drivers of the cost is the degree of audit scrutiny imposed by audit firms, with a large number of respondents believing the level of scrutiny placed on non-investment asset valuations being disproportionate to the audit of the financial statements as a whole.

3.13 The lack of market data to prepare verifiable audit evidence was also noted as a limitation of the current regime.

3.14 There was a general consensus that the inconsistency in the accounting policy for infrastructure assets for local government compared to central government is a major limitation of the current regime.

Alternative valuation discussions

3.15 The majority of respondents supported HMT in exploring alternative accounting policy options.

3.16 The most popular alternative valuation option was Option 3 (differential regime by asset class) followed by Option 1 (historical deemed cost). The least popular option was Option 4 (no change).

3.17 Respondents noted that Option 3 has the potential to address challenges raised by preparers, such as the limitation of alternative uses of valuation information and the time and cost burdens. This is because it may allow the application of a relevant and practically achievable accounting policy and enables the public sector to apply the optimum cost/benefit measurement for each type of asset class, depending on the nature and intended use of the asset.

Summary

3.18 The results of the scaled scoring on the uses and limitations of the current regime, demonstrated that there is significant interest from stakeholders to support HMT in exploring ways to improve the current regime.

3.19 The outcome of the survey confirmed the qualitative evaluation findings. Although there are some alternative uses to the valuation information produced as part of the current regime, and acknowledgement that it can be used in strategic decision-making process, ultimately there is a lack of incentive to do so. In addition to this, the current regime is noted as time-consuming and the audit requirements for non-investment asset valuations are disproportionate to the audit as a whole.

Chapter 4

Main findings from the thematic review

4.1 The thematic review found that stakeholders support an exploration of improvements to the current regime.

4.2 The review considered the views of users, preparers and auditors and found that, while the current regime does have strengths, the uses of the financial information provided by the current regime have been somewhat limited.

4.3 Initial feedback to the four options presented, as part of the alternative valuation discussion, showed that Option 3 (differential regime by asset class) was most popular. This recognises that the costs and value (to users) of holding assets at valuation can vary by asset class.

Next steps

4.4 On 9 March 2023, HM Treasury published a Consultation Paper[10] to consult on possible changes to the current regime. The alternative options in the Consultation Paper are informed by the findings from the thematic review.

4.5 The alternative options in the Consultation Paper seek to balance the purposes of government financial reporting, the needs of users and producers of the financial information, value for money considerations and the importance of timely financial reporting.

4.6 The Consultation Paper puts forward four options:

- Option 1 – Historical deemed cost model
- Option 2 – Revaluation model: fair value for all non-investment assets in accordance with IFRS
- Option 3 – Refinement of classes of non-investment assets with valuation method based on asset class
- Option 4 – Periodic reset to current valuation

4.7 HM Treasury have proposed an initial preferred option (Option 3), 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.

4.8 The proposed changes in Option 3 are targeted rather than a wholesale change, and draw on existing categorisations applied in the FReM. The proposed changes are summarised in Table 4.A.

[10] HMT - Thematic Review of Non-investment Asset Valuation Consultation Paper

Table 4.A: Initial Preferred 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 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

4.9 The Consultation Paper 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 initial preferred proposed changes were published for comment only.

4.10 The public consultation closed on 18 May 2023. The proposals presented above may be modified in light of comments received through the consultation process before being formally presented to the Financial Reporting Advisory Board (FRAB). HM Treasury aim to finalise any changes to FReM requirements by the end of 2023/24, although this is subject to change. Ahead of this, an Exposure Draft will be issued to consult on specific FReM requirements and transition and implementation considerations before any changes are finalised.

4.11 The Consultation Paper proposed that any changes to FReM requirements would be effective from 1 April 2025. However, the effective date of any FReM changes will be dependent on the Consultation Paper responses, stakeholder feedback, and FRAB review.

HM Treasury contacts

This document can be downloaded from www.gov.uk

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