HM Treasury

Financial Reporting Advisory Board Paper

Thematic Review – valuation of non-investment assets

Issue:	HM Treasury's public consultation on non-investment asset valuation for financial reporting purposes has concluded. This paper sets out proposed changes to the regime based on feedback from the public consultation and a newly established working group.
Impact on guidance:	New guidance will be issued for transition to the new regime.
IAS/IFRS adaptation?	Yes – the proposals will change the IAS 16 & 38 adaptations in the FReM.
Impact on WGA?	Yes – the proposals will change the measurement base of some IAS 16 and 38 assets in WGA.
IPSAS compliant?	Yes – the proposals are considered to be substantially complaint with IPSAS. They align with the IPSAS 17 (Property, Plant and Equipment) requirement to apply either the cost model or revaluation model as an accounting policy by class of PPE.
Interpretation for the public-sector context?	Yes – the proposals prescribe a differential valuation regime, based on the asset type.
Impact on budgetary regime and Estimates?	Yes – but the changes will remain consistent with accounting treatment
Alignment with National Accounts	No – but WGA asset values and depreciation are not used as a National accounts data source.
Recommendation:	**That the Board agree on the proposed changes in this paper and support a single-item meeting to be held in Summer 2023 to agree on issuance of an Exposure Draft to consult on the changes.**
Timing:	HM Treasury intends to issue an Exposure Draft as soon as possible after the forthcoming single-item meeting, with a view to finalising requirements by the end of financial year 23/24.. The effective date of any changes to FReM guidance still needs to be confirmed (this is one of the areas covered in this paper).

DETAIL

Background

1. HM Treasury has conducted a thematic review of non-investment asset valuation for financial reporting. The review's scope was defined as IAS 16 and IAS 38 assets within the boundary of Whole of Government Accounts. The review contributed 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. At the November 2022 FRAB meeting HM Treasury set out the findings of the review and the final report from our advisors, Deloitte, was made available to the Board.

3. In January 2023 a single-item meeting took place where FRAB agreed to the issuance of a public consultation on non-investment asset valuation. The Consultation Paper contained specific proposals for change from the current requirements, balancing the needs of users and producers of the financial information, value for money considerations and the importance of timely financial reporting. The consultation closed for responses on 18 May 2023.

4. During the consultation period, in May 2023, HM Treasury established a technical working group for the work on valuation of non-investment assets for financial reporting. The working group includes stakeholders from across the public sector; namely, preparers, auditors, valuers, standard-setting authorities, and users. There have been three working group meetings that have taken place to date.

5. This paper sets out findings from the Consultation Paper responses and feedback from the working group discussions. Taking all feedback into account, the paper also sets out HM Treasury's specific proposals for the valuation of non-investment assets for financial reporting purposes and asks whether FRAB agrees with these proposals (for some areas, FRAB is asked for formal agreement, and in other areas, FRAB is asked for agreement in principle subject to further work being done). This paper in addition sets out the proposed forward timelines for further consultation and implementation of the proposed changes.

6. HM Treasury are only making recommendations to the Board for FReM requirements.

7. CIPFA are also in support of the proposals being put to FRAB in this paper, subject to further work being performed around specialised and non-specialised assets, as outlined above. HM Treasury will continue to work with CIPFA to ensure any proposals and progression reflect consistency, where possible, across the public sector.

8. In deciding whether to move ahead with changes to non-investment asset valuation, FRAB will need to answer the following questions:

    i. *What overall approach should be taken to a non-investment asset valuation regime?* After analysing responses from the consultation paper and considering feedback from the working group, HM Treasury are proposing Option 3 in the Consultation Paper (differentiation of valuation method based on asset class) to FRAB. FRAB are asked to make a final decision on this area in the June 2023 FRAB meeting.

    ii. *If FRAB support Option 3 (differentiation of valuation method based on asset class), which measurement bases should be used for specific classes of assets, and how should classes of assets be defined?*
    After analysing consultation responses, HM Treasury are proposing that the asset classes that currently exist in the FReM mainly be retained. HM Treasury are proposing the following for each of the 7 asset classes contained in the Consultation Paper:

a. For heritage asset, surplus asset and intangible asset classes, HM Treasury request FRAB to make a final decision in the June 2023 FRAB meeting on the measurement bases used for these assets.

b. For social housing assets, HM Treasury are not making a recommendation in this meeting, as these assets are held exclusively in local government and therefore not covered in the FReM, but consultation responses on this area have been passed to CIPFA for them to make any relevant decisions.

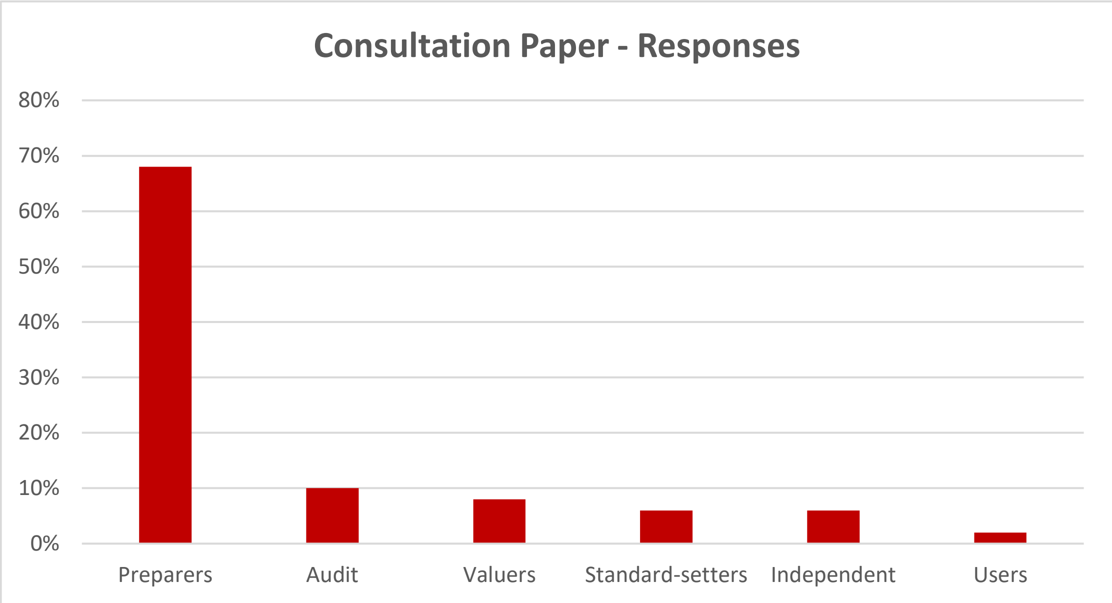
c. For networked assets, specialised assets, and non-specialised assets, HM Treasury request FRAB to provide approval in principle of our proposals here, subject to further analysis being performed. HM Treasury will then ask FRAB for a final decision in a Summer 2023 single-item meeting.

iii. *How exactly should FReM requirements change, bearing in mind issues like disclosure, presentation, and transition requirements?*
HM Treasury will present FRAB with proposals on these issues in the Summer 2023 single-item meeting, as well as asking FRAB to agree on issuance of an Exposure Draft to consult on the changes.

9. For ease of reference, please see the following list of topics discussed in the paper and corresponding questions for FRAB, along with paragraph references:

Consultation Paper Findings

10. The Consultation Paper provided a vehicle to gather stakeholder views on alternative options to the current regime of asset valuation requirements, which were informed by the findings of the thematic review. HM Treasury received 49 responses to the public consultation, from preparers (including preparers from central government, local government, and devolved administrations), standard-setting authorities, auditors, valuers, users, and independent



organisations.

11. The Consultation Paper presented 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
    - *Option 4a – Periodic reset of deemed cost to current valuation (adapted historical cost model)*
    - *Option 4b – Continue to apply current values but quinquennially (adapted revaluation model)*

12. The Consultation Paper set out a summary, advantages, disadvantages, and possible mitigations to any risks of each option. The paper asked respondents whether they agreed with HM Treasury's assessment of each option. HM Treasury proposed an initial preferred option (Option 3) which proposes a differential approach to valuation by classes of asset.

13. HM Treasury has analysed responses to the consultation, also considering working group feedback, and have divided findings into three sections:

    I. Options Analysis *[questions 1 – 11 of the Consultation Paper]*

II. Option 3 – Detailed Analysis *[questions 12 – 24 of the Consultation Paper]*
III. Implementation and Transition *[questions 25 – 30 of the Consultation Paper]*

Options Analysis

Option 1 – Historical deemed cost model

14. Option 1 considered transition to the historical cost model by all public sector bodies for all classes of non-investment assets. Option 1 proposed that the transition value would be assumed to equal the current value of the asset at the transition date (i.e., the deemed cost).

15. HM Treasury's assessment of Option 1, in the Consultation Paper, noted that the main challenges would be: the potentially significant disparity between the carrying value under the historical cost model and current values due to annual price, leading to the risk of less useful and relevant information per the factors of the Conceptual Framework; historical cost valuations resulting in limited access to historical cost valuation data that may raise issues around a lack of transparency; and the risk of limiting the ability of users of financial statements to assess, corroborate or challenge management's stewardship of assets.

16. For Option 1, a minority of respondents (12%) disagreed with HM Treasury's assessment of Option 1 and supported this option. These respondents noted that historical cost is simpler and less costly to produce and maintain compared to alternative options. There was also an argument that historical cost offers value for money. The majority of respondents (84%) agreed with HM Treasury's assessment of Option 1. There were also a small minority of respondents that did not provide an answer to this specific question.

17. The working group acknowledged that although Option 1 can be appreciated for its simplicity, the information presented by historic cost valuation is arguably not especially relevant, and not useful for the purposes of financial reporting in the public sector. Working group members discussed alternative uses of asset valuation information produced from current FreM requirements, such as using valuation information for business case analyses, and noted that historic cost information would not present the same level of relevance for these alternative uses.

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

18. Option 2 considered transition to a revaluation model where each asset is carried at fair value at the date of revaluation (less subsequent depreciation and impairment). The revaluation model would be applied prospectively in line with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requirements.

19. HM Treasury's assessment of Option 2, in the Consultation Paper, noted that the main challenges would be: the limited observable market comparators for certain asset classes in the public sector and the additional time and effort that may be required to identify the most advantageous market for fair value measurement. The most advantageous market would be required to help determine the highest and best uses of the asset and apply appropriate valuation techniques.

20. For Option 2, a minority of respondents (6%) disagreed with HM Treasury's assessment of Option 2 and supported this option. These respondents noted that fair value may provide more relevant information to users of the financial statements. However, 88% of respondents agreed with HM Treasury's assessment of Option 2. There were also a small minority of respondents that did not provide an answer to this specific question.

21. The working group echoed consultation responses to Option 2, agreeing that it would not be the best option for the public sector for all asset classes. Members raised the concern that identifying the most advantageous market for public sector assets could prove difficult and result in additional costs that may potentially outweigh any benefits of the measurement basis.

Option 3 – Differentiation of valuation method based on asset class

22. Option 3 considered a reassessment of distinct asset classes for financial reporting purposes, and the application of a separate measurement basis for each class of assets.

23. HM Treasury's identified Option 3 as the lead option, in the Consultation Paper, stating it will enable differentiation of the valuation approach depending on the nature of the assets, to realise the maximum financial reporting benefits whilst minimising associated costs.

24. 84% of Consultation Paper respondents agreed with HM Treasury's assessment of Option 3. Respondents agreed with the *concept* of Option 3 (i.e., maintaining a differential approach to valuation by classes of assets) rather than full agreement of all proposed measurement bases for each asset class presented in the Consultation Paper. Please see Option 3 section below for further analysis of proposed measurement per asset class.

25. Respondents noted having differential valuation bases for different asset classes is the best way to provide meaningful information to users of the accounts, given decisions on assets are not taken in aggregate. It was also acknowledged that all asset classes presented in the Consultation Paper currently exist in the FReM and there was no risk of ambiguity in introducing new asset classes.

26. For Option 3, 10% of respondents disagreed with HM Treasury's assessment of Option 3. These respondents suggested that Option 3 would significantly increase the amount of time, effort and cost spent on such a mixed measurement base. There was a small minority of respondents that did not provide an answer to this specific question.

27. The working group agreed with the concept of Option 3 generally, including the HM Treasury assessment in the Consultation Paper around the merits of differentiation of valuation method based on asset class.

Option 4a – Period reset to current valuation ('adapted historical cost model')

28. Option 4 explored two ways of introducing a periodic reset to current valuation. Option 4a considered 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).

29. HM Treasury's assessment of Option 4a, in the Consultation Paper, recognised that, although this option would seek to compensate for the deteriorating relevance of the

deemed historical cost approach and constrain the need to demonstrate no material difference between the carrying value and current value at each reporting date, using historic cost and current value may introduce tension with the IFRS Conceptual Framework as it does not appear to allow for a combination of the two.

30. 71% of respondents agreed with HM Treasury's assessment of Option 4a. 73% of respondents acknowledged a potential risk that Option 4a would not be considered true and fair if there is a material difference between carrying value and current value at the reporting date, because it would not be clear which valuation basis should be used. This could then undermine the clarity of the information presented to the users of the financial statements. For this reason, respondents agreed that a pronouncement from the relevant regulator would be necessary to address any ambiguity on what would be considered true and fair.

31. Respondents also raised concerns about the practicalities of initially invoking historical cost to then be replaced with a current valuation. Respondents argued that there would appear to be no cost or time saving benefits, or other reason, to introduce historic cost figures in the first place. The first periodic revaluation could instead simply be applied to the previously existing last revaluation figures rather than to a one-off appearance of historic cost data.

32. Although 53% of respondents agreed Option 4a *could* be used in conjunction with Option 3, most of these respondents would not necessarily support Option 4a as it would create tension with the Conceptual Framework, and so would not support using it in conjunction with Option 3.

Option 4b – Periodic reset to current valuation ('adapted revaluation model')

33. Option 4b considered continuing to apply current values, as per the current measurement base, but to introduce a FReM adaptation to IFRS prescribing that revaluations shall only be undertaken quinquennially. This would be an adapted revaluation model.

34. The Consultation Paper suggested that Option 4b would seek to obtain the same results as Option 4a but, as this would be a period reset of current values, it would eliminate the risk of tension with the Conceptual Framework.

35. 71% of respondents agreed with HM Treasury's assessment of Option 4b and 65% of respondents agreed this option could be used in conjunction with Option 3. It was noted that HM Treasury's proposed mitigation to implementing the changes across phased tranches appears to be a reasonable solution to the problem of concurrent quinquennial valuations. Option 4b was seen as a better overall compromise than Option 4a as it applies a single measurement basis to a class of assets and looks to keep assets at a current value using some level of unindexed or indexed proxy between revaluations.

36. The working group acknowledged the merits of both Option 4; however, were mindful of unintended consequences such as quinquennial revaluations could impact the PDC calculation for the health sector and a general increase in audit scrutiny. The working group discussed mitigations to these such as introducing the option on a rolling basis with indexation, to address any significant fluctuations by potentially bringing valuations in line with market movements, and working closely with auditors to ensure audit scrutiny is not disproportionate to the work being carried out.

HM Treasury analysis and recommendation for FRAB

37. After considering consultation responses, HM Treasury recommend taking forward Option 3 (i.e., a differential approach to valuation by asset class). The reasons we had for putting this option forward as HM Treasury's preferred option are unchanged. This option accommodates different measurement bases by class of assets, enabling the public sector to apply the optimum measurement basis for each type of asset class, depending on the nature and intended use of the asset. Responses from the consultation paper have confirmed that it would not be advisable to implement a single measurement base across all assets in the public sector (as Option 1 and Option 2 suggest), because a single measurement basis would not reflect the variation and the unique nature of the assets held in the public sector and so could significantly impair the usefulness of the financial statements. Responses from the consultation paper have also confirmed that HM Treasury's initial stance in the consultation paper that it would not be advisable to implement Option 4a, even in conjunction with Option 3. However, HM Treasury propose Option 4b to be used in conjunction with Option 3 for specialised assets. This is discussed in further detail in the next section.

38. As representatives of the primary user of central government accounts, the Scrutiny Unit at the House of Commons, have also confirmed that they accept HM Treasury's case for different valuation methods based on asset classes. They have expressed support for use of current value over historical cost as a general principle, based on the concept that it is more relevant for Parliamentary users.

Decision needed: Is the Board content to implement the concept of Option 3 – a differential approach to valuation based on asset class?

Option 3 – Detailed Analysis

39. The Consultation Paper responses confirmed there was support for the concept of HM Treasury's preferred option (Option 3) as a concept. However, only 47% of respondents agreed that Option 3, with the specific asset classes and measurement bases proposed in the paper, would improve financial reporting for users of the accounts.

40. This section of the paper is divided into two sections. The first part discusses those asset classes where the Consultation Paper's proposed measurement basis was supported by respondents, and asks FRAB to make final decisions around the measurement basis for these assets. The second part details those asset classes where the Consultation Paper's proposed measurement was not fully supported by respondents and where HM Treasury intend to make changes to these proposals. For these asset classes, FRAB are asked to agree to HM Treasury's recommendations in principle subject to further analysis, and will make final decisions in a single-item Summer 2023 meeting.

Heritage Assets

41. In the Consultation Paper, HM Treasury set out the current measurement for heritage assets. For operational heritage assets, the measurement basis is the same for other IAS 16 assets. For non-operational heritage assets, the measurement basis 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. HM Treasury proposed no change to the current measurement basis.

42. The Consultation Paper did not propose any change to the definition of heritage assets, or the distinction between operational and non-operational heritage assets, as is currently contained in the FReM[1].

43. 88% of respondents agreed that there should be no change to the measurement of heritage assets. There was general consensus that maintaining the existing approach will promote consistency over time and respondents agreed with the assessment made in the Consultation Paper that any change creates the risk of dual accounting regimes, as many charity entities in the public sector holding significant heritage assets have elected the revaluation model under the Charities SORP. The remaining respondents did not provide an answer to this specific question due to the class of asset not being relevant to their entity.

Social Housing Assets

44. In the Consultation Paper, HM Treasury set out that the current measurement for social housing assets is existing use value (EUV). HM Treasury proposed no change to the current measurement basis.

45. The Consultation Paper also set out the definition of social housing assets. 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.

46. 86% of respondents agreed that there should be no change to the measurement of social housing assets. 2% of respondents disagreed and stated that a discounted cash flow model might be more appropriate. The remaining respondents did not provide an answer to this specific question due to the class of asset not being relevant their entity. It is worth noting that 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 Accounts boundary. HM Treasury will work with CIPFA/LASAAC, as the relevant authority, to share further responses of this particular question and are not asking FRAB any questions on this matter in this paper.

Surplus Assets

47. The Consultation Paper set out that the current measurement basis for surplus assets is fair value, in accordance with IFRS 13 *Fair Value*. HM Treasury proposed no change to the current measurement basis.

48. The Consultation Paper did not propose any change to the definition of surplus assets, as is currently contained in the FReM[2].

49. 90% of respondents agreed that there should be no change to the measurement of surplus assets. Respondents noted that current measurement allows organisations to be cognisant

[1] As per the FReM, non-operational assets are those that are held primarily in pursuit of its overall objectives in relation to the maintenance of the heritage. 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.
[2] As per the FReM, these 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.

of potential alternative economic use for assets they are not holding for their service potential. The remaining respondents did not provide an answer to this specific question due to the class of asset not being relevant their entity.

Intangible Assets

50. The Consultation Paper set out that the current measurement basis for intangible assets is market value in existing use or historical cost for low value assets or assets with short useful economic lives. HM Treasury proposed historical (deemed) cost as a new measurement basis.

51. The Consultation Paper also sets out that intangible assets are those which fall within the scope of IAS 38[3].

52. 88% of respondents agreed that there should be a change to the measurement of intangible assets and agreed with the proposed measurement of historical (deemed) cost. Respondents noted that this would introduce consistency and is an appropriate measurement for this class of asset, as there is typically a lack of observable market inputs for valuation purposes with the current measurement basis (market value in existing use for those intangible assets that do not have short useful economic lives). 4% of respondents disagreed with the proposed measurement of intangible assets because public sector bodies are becoming more involved in commercial activity and so maintaining market value in existing use would be more appropriate. However, the respondents who disagreed did accept the wider considerations being addressed, such as the lack of observable market inputs for valuation purposes for the current measurement, as some entities hold a significant volume of intangible assets which present a valuation challenge. Therefore, a change to (deemed) historical cost provides a viable solution. The remaining respondents did not provide an answer to this specific question due to the class of asset not being relevant their entity.

53. HM Treasury has tested our proposal for the asset classes discussed above with the working group, who supported our proposals.

54. In summary, for the asset classes discussed above, HM Treasury maintain the initial recommendation made in the Consultation Paper for the proposed measurements. These are:

Asset Class	Proposed FReM Measurement
Heritage Assets	No change proposed compared to FReM
Surplus Assets	No change proposed compared to FReM
Intangible Assets	Historical (deemed) cost (change from current FReM requirement of market value in existing use or historical cost for low value assets or assets with short useful economic lives)

[3] An identifiable non-monetary asset without physical substance.

55. HM Treasury are not proposing to change the definition of heritage assets, surplus assets or intangible assets.

56. Note again that HM Treasury are not asking FRAB to make any decisions on social housing assets, as these are not covered in the FReM, but have passed all relevant information to the CIPFA/LASAAC secretariat.

Decision needed:

I. **Does the Board agree with HM Treasury's recommendations not to change the definitions of the heritage asset, surplus asset, and intangible asset classes?**
II. **Does the Board agree with HM Treasury's recommendations for measurement bases for the heritage asset, surplus asset, and intangible asset classes?**

Networked Assets

57. The Consultation Paper set out that the current measurement basis for networked assets is DRC (with the exception of English, Welsh and Scottish Local Authorities). HM Treasury proposed no change to the current measurement basis for central government but advocated consistency, where possible, across the public sector. HM Treasury identified that the characteristics of this asset class are so specific that obtaining a fair value would ultimately mean that the measure would be a depreciated replacement cost, so to continue with the current measurement basis seems to be the most practicable method.

58. The Consultation Paper sets out that, as per the FReM, networked assets comprise assets that form part of an integrated network servicing a significant geographical area.

59. 65% of respondents agreed with the proposed measurement for networked assets. The majority of respondents who disagreed with the proposed measurement (27%) were local authorities. The remaining 8% of respondents did not provide an answer to this specific question due to the class of asset not being relevant their entity. Some local authorities noted that the introduction of DRC for Highways Network Accounting in Local Authorities was ruled out by CIPFA in 2016 and argued that the introduction of CIPFA would increase the resource associated with valuation. However, some local authorities did acknowledge the limitations of historical cost. Central government entities who have a significant amount of networked assets agreed with the proposed change.

60. CIPFA support the movement to DRC for networked assets and are seeking to develop a long-term workable approach to valuation requirements for networked assets. This discussion is being framed in terms of DRC. CIPFA recognise that this is now a live issue for local authorities where there is a proposed move to DRC for infrastructure assets which would have significant cost implications in view of the extent and complexity of the local roads network, particularly in England. CIPFA would note that while the local authority Code has prescribed a treatment for infrastructure assets (i.e., network assets) using historical cost, this was as a practical expedient in the early 1990s, having regard to the very significant practical difficulties and resource costs in developing information on local authority highways networks. CIPFA is mindful of the practical issues relating to any move to DRC and has undertaken a survey of local authority practitioners to consider the impact the introduction of a new measurement basis will have. The survey deadline was 14 June 2023.

61. After considering the consultation responses, HM Treasury agree that DRC should be maintained as the measurement for networked assets in central government. HM Treasury

continue to agree with the rationale for DRC set out in the Consultation Paper. Additionally, the distinguishing characteristics of networked assets, such as long useful lives, complexity of componentisation and frequency of alterations support a DRC approach. However, bearing in mind consultation responses, there are a few specific areas around networked assets that HM Treasury would like to explore further before making final recommendations to FRAB. Again, HM Treasury are only asking for FRAB's agreement in principle to the proposal that networked assets should be measured at DRC, subject to this further analysis being performed.

62. One outstanding issue for networked assets is around the frequency of revaluations. The FReM currently states that, as part of the road network, Land, Structures and Communications will be accounted for following the guidance in IAS 16 and does not provide any further guidance on frequency of revaluations. Road surface assets, and all other networked assets which are prescribed to follow the road surface accounting methodology, are subject to annual valuations. HM Treasury intend to explore whether the frequency of revaluations for networked assets could follow a similar proposal to that presented for specialised assets below (i.e., in conjunction with Option 4b). Consultation Paper responses highlighted that networked assets could be perceived as a type of specialised asset and so it would help for both asset classes to have the same measurement base.

63. Another outstanding issue is the definition of networked assets, and the relationship between networked assets and specialised assets. Respondents noted a risk of complexity and ambiguity in having different asset classes, and potentially different measurement bases, for networked assets and specialised assets. As inferred to above, respondents argued that a networked asset is specialised in nature, so could be viewed as a subset of the general specialised asset class. These respondents argued that it seems difficult to justify why one type of specialised asset is valued differently to another 'type' of specialised asset. As discussed later in the paper, HM Treasury is exploring a DRC measurement for specialised assets as well, which further raises the question of whether separate asset classes for networked assets and specialised assets are necessary.

64. Finally, HM Treasury is aware of the work CIPFA are undertaking with regards to DRC and so HM Treasury will continue to work with CIPFA to coordinate future proposals in this area.

Decision needed: Does the Board agree with HM Treasury's proposal for networked assets to be measured at DRC in principle, subject to further work being performed around the details of the interaction with specialised asset guidance, and revaluation frequency, with final decisions being taken in a single-item meeting in Summer 2023?

Specialised Assets

65. The Consultation Paper set out that the current measurement basis for specialised assets is DRC. HM Treasury proposed historical (deemed) cost as the proposed new measurement basis in the Consultation Paper.

66. In the Consultation Paper, HM Treasury sets out the definition of specialised assets as per the FReM[4].

[4] Specialised assets 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.

67. 61% of respondents agreed with the proposed measurement of specialised assets, that is a move from DRC to historical (deemed) cost. Respondents noted that the proposed measurement would remove the risk of subjectivity of DRC. It was also acknowledged that historical (deemed) cost would remove complexity and cost from the current valuation process, which could have a positive impact on the timeliness of the publication of annual reports and accounts across central government.

68. However, consultation responses have exposed concerns that there is a lack of clarity on how derecognition and componentisation will work on transition to a historic deemed cost model, as well as how existing revaluation reserves would be treated. Consultation responses and working group feedback also raised the risk that historic cost data, regardless of whether or not efforts are made to adjust it for subsequent capital expenditure and derecognition of replaced components, will result in carrying values that bear no relationship to the current value and which will not reflect the remaining service potential of the in-use assets.

69. Respondents and working group members also raised that there is the potential for unintended consequences from a move to historic (deemed) cost that could create new audit issues, such as being asked to identify historic costs for components where that information is not available.

70. Although preparers noted that the proposed measurement would save time and costs, there were concerns that it would not improve the reliability of the financial information reported. Members from the working group echoed responses from the Consultation Paper and raised that having different measurement bases for networked assets and specialised assets could create ambiguity, as discussed in the networked assets section above.

71. The Scrutiny Unit, at the House of Commons also agreed that parliamentarians would struggle to accept or understand that specialised assets (such as prisons, schools, and military equipment) have low values as would result from a historic (deemed) cost measurement basis.

72. For specialised assets, HM Treasury would recommend changing the measurement basis from that originally presented in the Consultation Paper, to reflect responses to the consultation. HM Treasury propose to maintain the current measurement in the FReM for specialised assets - DRC - but introduce the application of Option 4b in the Consultation Paper (i.e., introducing an IAS 16 adaptation prescribing that revaluations shall only be undertaken quinquennially).

73. This proposal seeks to constrain the need to demonstrate no material difference between the carrying value and current value of specialised assets at each reporting date because, as outlined in Option 4b, revaluations shall only be undertaken quinquennially. Alongside this, HM Treasury propose providing an updated version of the 'HMT Guidance on Asset Valuation' which can be used in conjunction with the FReM. The guidance, originally published in 2007, will help drive greater consistency in the practical application of DRC. This guidance was updated in 2014 to accommodate updated references to the Royal Institute of Chartered Surveyors (RICS) guidance.

74. The Consultation Paper originally proposed a move to historical deemed cost because it would remove complexity and cost and could improve the reliability of the financial information provided. Even with the new proposal, the reliability of financial information could be improved by introducing consistency in application of DRC across the public sector

which could also diminish the risk of complexity and reduce some costs associated with DRC.

DRC considerations

75. The ‘HMT Guidance on Asset Valuation’ document was originally produced by the ‘Asset Valuation and Capital Charging Group’ that was established and chaired by HM Treasury from 2005 to 2007. It explored a number of issues and concerns that had arisen regarding asset valuations and capital charging, with a particular focus on the practical aspects of preparing appropriate valuations using DRC methodology. The document is still relevant today because it sets out a number of public sector asset valuation assumptions that require to be applied by valuers when undertaking a DRC valuation. HM Treasury believe that it is a potential lack of awareness and adherence to these requirements amongst some valuers and, perhaps, some auditors that may be contributing to some of the valuation and audit problems, concerns and inconsistencies currently being experienced.

76. Up until the 2014-15 FReM, the additional guidance was explicitly referenced in the FReM. From 2015-16 onwards, the FReM has not referenced the guidance and it is no longer accessible. HM Treasury cannot identify why reference to the guidance was removed from the FReM; however, this was most likely an unintended consequence of the simplifying and streamlining project implemented for the first time in the 2015-16 FReM.

77. As part of this revised proposal for specialised assets, HM Treasury recommend revisiting the guidance with input from preparers, valuers, and auditors to update the guidance to drive greater consistency in application of DRC. This will include ensuring there is an explanation and justification for the purpose of DRC and how to practically apply DRC.CIPFA support the idea of developing update guidance on DRC and have confirmed they are content to support HM Treasury in further developing this guidance.

78. Between June FRAB and a single-item meeting in Summer 2023, HM Treasury will explore the merits of reintroducing guidance on DRC, and test with stakeholders, such as preparers and auditors, through the working group and targeted conversations whether they think it will address the subjectivity risk that DRC can present. HM Treasury will specifically focus on whether additional guidance could help drive greater consistency in the practical application of DRC, and whether this could assist auditors too.

Revaluation frequency considerations

79. The Consultation Paper identifies that the main challenge of Option 4b (i.e., introducing quinquennial valuations/the adapted revaluation model) 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. The other risk of Option 4b is the risk of the majority of the public sector revaluing assets at the same time, for example quinquennially from the date of transition.

80. Responses to the Consultation Paper supported application of Option 4b in conjunction with Option 3 generally. In particular, the audit community specify that specialised assets would benefit most in application of Option 4b and suggested Option 4b combined with indexation in intervening years would present a true and fair view.

81. When HM Treasury tested the specific proposal of implementing Option 4b in conjunction with specialised assets with the working group, the working group generally supported that proposal especially as it could potentially reduce the cost to preparers and auditors with less frequent valuations. Certain members of the working group explicitly supported the suggestion in the Consultation Paper of a prescription of a rolling programme of revaluation with indexation, if Option 4b were to be implemented in conjunction with specialised assets, as this may justify a true and fair audit opinion.

82. With regards to the periodic timing of revaluations across government, there was support for the mitigation suggested in the Consultation Paper that there could be phased tranches to avoid burden on preparers, valuers, and auditors. As presented in the Consultation Paper, HM Treasury still maintain that this could be viable mitigation.

83. HM Treasury has tested our updated proposal for specialised assets with the working group, who supported this proposal. The working group strongly advocated revived guidance that clearly explains the purpose and methodology of DRC that would bring consistency for preparers, valuers, and auditors.

84. HM Treasury are only proposing implementing Option 4b in conjunction with specialised assets at this stage. The reason why HM Treasury are not proposing to implement Option 4b in conjunction with non-specialised assets, at this stage, is because it could potentially add an additional layer of complexity to the newly formed proposal HM Treasury present in the next section. The reason why HM Treasury are not proposing to implement Option 4b with intangibles asset, because that asset class is being proposed to move to historical deemed cost, nor with surplus assets or heritage assets as respondents agree with HM Treasury's proposal for no change to the current regime. In addition to this, heritage assets follow the revaluation model under the charities SORP.

85. Between June FRAB and a single-item meeting in Summer 2023, HM Treasury will look to explore the practicalities of introducing Option 4b with indexation. HM Treasury will also assess the possibility of implementing this proposal in phased tranches across central government.

Decision needed: Does the Board agree with HM Treasury's proposal for specialised assets to be measured at DRC with quinquennial revaluation in principle, subject to further work being performed around reintroducing guidance on DRC for the public sector and revaluation frequency, with final decisions being taken in a single-item meeting in Summer 2023?

Non-specialised Assets

86. In the Consultation Paper, HM Treasury set out the current measurement basis for non-specialised assets is market value in existing use. HM Treasury proposed Fair Value (in accordance with IFRS 13) as the proposed new measurement basis in the Consultation Paper.

87. HM Treasury set out that non-specialised assets are assets 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.

88. 41% of respondents agreed with the proposed measurement of non-specialised assets, that is a move from market value in existing use to fair value (in accordance with IFRS 13). These respondents noted that fair value may help provide more relevant information for asset management purposes.

89. The main concern presented from respondents who disagreed with the Consultation Paper proposal was that there are instances where operational assets held for their service potential will not be utilised to their full potential. The Consultation Paper outlined that 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.

90. Respondents noted that a fair value valuation requires a valuer to consider the site for its highest and best use value and that introduces a level of subjectivity to the valuation through the valuer's professional judgement. In addition to this, responses argued that the assessment of highest and best use for non-specialised assets is often not straightforward.

91. The working group discussions supported the responses to the Consultation Paper and specifically echoed concerns of moving to measuring non-specialised assets at fair value due to the majority of public sector non-specialised assets being held for operational capacity rather than at their full service potential.

92. After considering the Consultation Paper responses, HM Treasury has developed a new proposal for non-specialised assets. For these assets, HM Treasury propose to follow the current operational value measurement basis set out in the new IPSAS 46 *Measurement* standard for non-specialised assets held for their operational capacity, and measure non-specialised assets held for their financial capacity at fair value using the principles in IFRS 13.

93. IPSAS 46 *Measurement* provides new guidance in a single standard addressing how commonly used measurement bases should be applied in practice. It brings in generic guidance on fair value for the first time, and introduces current operational value, a public sector-specific current value measurement basis addressing constituents' views that an alternative current value measurement basis to fair value is needed for certain public sector assets. Please see Annex B for a further explanation of IPSAS 46 and a brief comparison to current FReM requirements.

94. Respondents to the IPSASB Measurement Consultation Paper and Measurement Exposure Draft had similar concerns around fair value measurement as respondents to the HM Treasury Consultation Paper (see paragraphs 15-18). Respondents identified challenges in applying fair value in the public sector, especially relating to when an item is held for its operational capacity. Respondents argued that it is difficult to use fair value measurement for these assets because concepts such as 'highest and best use' and 'maximising the use of market participant data' may not apply.

95. The IPSASB have responded to this concern by developing current operational value as a public sector specific measurement basis. Current operational value is the amount the entity would pay for the remaining service potential of an asset at the measurement date. To reflect the unique characteristics of assets held in the public sector, current operational value measures assets in their existing use. Current operational value applies to all assets when another IPSAS requires or permits:

- One or more of the measurement bases defined in IPSAS 46 (historical cost model or current value model); and
- Measurement that are based on one or more of the measurement bases (e.g., fair value less costs of disposals).

96. IPSAS 46 does not apply to the following:

- Leasing transactions accounted for in accordance with IPSAS 43, *Leases*
- Transactions accounted for in accordance with IPSAS 32, *Service Concession Agreements: Grantor*; and
- Net realisable value in IPSAS 12, *Inventories* or value in use in IPSAS 21, *Impairment of Non-Cash Generating Assets* and IPSAS 26, *Impairment of Cash-Generating Assets*

97. HM Treasury propose to introduce the current operational value measurement basis for non-specialised assets held for their operational capacity. HM Treasury also propose that IFRS 13 fair value measurement be used for non-specialised assets held for their financial capacity. Operational capacity and financial capacity are both terms introduced and used by IPSAS 46.

98. HM Treasury believe this approach is most appropriate for non-specialised assets specifically, because HM Treasury agree with consultation responses that some non-specialised assets held for their service potential will not be utilised to their full potential. Therefore, it is appropriate to consider how this class of asset can be divided into those held for operational capacity and those held for financial capacity.

99. A reason for the proposed measurement basis in the Consultation Paper was that IFRS 13 valuation techniques incorporate alternative uses and opts 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. The new proposal in this FRAB paper still proposes IFRS 13 for non-specialised assets held for financial capacity and so will still provide the benefits outlined in the Consultation Paper.

100. When tested with the working group, there was support for the updated proposal for non-specialised assets. The working group strongly agreed that not all non-specialised assets should be measured at fair value. In addition to this, the working group acknowledged the public sector could benefit from implementing a similar approach to IPSAS 46 as it would introduce consistency with the international standard.

101. The IAS 16 adaptation in the FReM effectively separates non-specialised assets held for operational capacity (to be measured at EUV), and all other non-specialised assets not held for their service potential should be valued in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* or IAS 40, *Investment Property* (both out of scope of this review). Where such assets are surplus, and do not fall within the scope of IFRS 5 or IAS 40, should be valued in accordance with IFRS 13 (as discussed above in the 'Surplus Assets' section of the paper. HM Treasury are proposing to introduce clearer guidance in the FReM, following the basis of IPSAS 46, to specifically distinguish between non-specialised assets held for operational capacity and financial capacity. For those held for financial capacity, HM Treasury intend to explore introducing specific guidance in the FReM for these assets, suggesting valuation in accordance with IFRS 13.

102. The current measurement basis for non-specialised assets is market value in existing use, which is defined in the RICS Red Book as Existing Use Value (EUV).[5] RICS have recently completed their own consultation on the definition of EUV. The outcome of this is still pending and HM Treasury will assess whether this captures the concept of current operational value.

103. At this meeting, FRAB are only being asked if they agree with this proposal in principle, subject to further work being performed by HM Treasury. Between June FRAB and the single-item meeting in Summer 2023, HM Treasury will explore whether any adaptations or changes would be needed to the IPSAS guidance around current operational value, and the distinction between assets held for operational capacity and financial capacity, for the UK public sector context specifically. HM Treasury will also assess whether the new definition of EUV captures the concept of current operational value, and whether this continue to be the measurement basis for non-specialised assets but those specifically held for operational capacity. HM Treasury will revert to FRAB with these details for their formal approval of this proposal in the forthcoming Summer 2023 single-item meeting.

Decision needed: Does the Board agree with HM Treasury's proposal for non-specialised assets to be measured using the principles in IPSAS 46 (i.e., current operational value for assets held for operational capacity and fair value for assets held for financial capacity) in principle, subject to further work being performed around understanding whether any changes need to be made to IPSAS 46 requirements for the UK public sector context, and the relationship between current operational value and EUV, with final decisions being taken in a single-item meeting in Summer 2023?

Effective date and other implementation issues

104. The Consultation Paper proposed an effective date of 2025/26 for any changes to FReM requirements. 74% of respondents agreed with this proposal. The main argument for those who disagreed was that April 2025 is the date for initial implementation of IFRS 17, which mean preparers already have one are of significant change in the same timeframe.

105. Some respondents also stated that implementation in 2024/25 could be possible, or a phased implementation for specific asset classes could be followed if FRAB were to agree to the proposals put forward by HM Treasury (for example, implementing the new measurement base for intangible assets to historical deemed cost before other changes).

106. Ultimately, responses and working group participants argued that it is most important to not rush any significant changes and for there to be consensus across the public sector with regards to any changes. HM Treasury agrees with this.

107. HM Treasury, therefore, preliminarily suggest an effective date of implementation of 2025/26. HM Treasury believe this will provide sufficient time for guidance to be finalised

[5] The FReM states that it is for valuers, using the Royal Institution of Chartered Surveyors; (RICS) 'Red Book' (RICS Valuation - Professional Standards), and following discussions with the entity, to determine the most appropriate methodology for obtaining either a current value in existing use or a fair value. The Red Book is issued by RICS as part of their commitment to promote and support high standards in valuation delivery worldwide. The publication details mandatory practices for RICS members undertaking valuation services. It also offers a useful reference resource for valuation users and other stakeholders.

and published with appropriate lead time for preparers to implement any changes. The effective date of IPSAS 46 is for periods beginning on or after 1 January 2025 so will also align with the proposed effective date of 2025/26, if the proposal for non-specialised assets is agreed. This is subject to the outcome of the June 2023 FRAB meeting and single-issue Summer 2023 meeting, and so FRAB will be asked to make a final decision on any effective date at the single-issue Summer 2023 meeting.

108. The Consultation Paper also set out the following areas where additional guidance may ultimately be needed (without proposing what specifically that guidance would be):

- Implementation and transition considerations
- Guidance on impairment, including impairment of non-cash generating assets, impairment indicators and impairment reviews
- Interaction with IFRS 16 *Leases* requirements

Respondents agreed that additional guidance would be helpful in these areas.

109. Responses also identified further that HM Treasury should consider when working on the Exposure Draft and application guidance. These include, but are not limited to:

- Disclosure and transition requirements
- Any wider implications of changing measurement requirements, including the interaction with budget requirements

110. As the Consultation Paper only contained high-level proposals of areas where guidance may be needed, HM Treasury plan to present the Board with a full proposal on all areas of guidance that need to be included in an Exposure Draft in the forthcoming single-item Summer 2023 meeting.

Next Steps

111. If FRAB approve HM Treasury's proposals in this paper, HM Treasury will move forward with developing the proposals for networked, specialised and non-specialised assets further, along with working up proposals on the detailed implementation areas mentioned above. FRAB will be asked to approve the final proposals for networked, specialised and non-specialised assets and the accompanying implementation guidance in a single-item meeting in Summer 2023, where they will also have sight of a draft Exposure Draft that HM Treasury will use to consult on these changes.

112. HM Treasury will also continue to work with other relevant authorities, particularly the CIPFA/LASAAC secretariat, to ensure that asset measurement requirements can be consistent across the public sector where possible.

HM Treasury

29 June 2023

Annex A

Proposed Changes (Option 3)				
Asset Category (using existing FReM categories)	Current Measurement	Proposed Measurement in Consultation Paper	*Consultation Paper Response*	*Proposed Measurement post-Consultation Paper*
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	65% agree with proposed measurement	No change proposed *Further consideration regarding interaction with specialised asset guidance, and revaluation frequency*
Specialised assets (PPE)	Depreciated replacement cost	Historical (deemed) cost	61% agree with proposed measurement	DRC - adapted revaluation model
Non-specialised assets (PPE)	Market value in existing use	Fair value	41% agree with proposed measurement	Current operational value (assets held at operational capacity) Fair Value (assets held at financial capacity)
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	88% agree with proposed measurement	No change proposed
Social housing assets	Existing use value	No change proposed	86% agree with proposed measurement	No change proposed
Surplus assets	Fair value	No change proposed	90% agree with proposed measurement	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	86% agree with proposed measurement	Historical (deemed) cost

Annex B – IPSAS 46 (Measurement)

1. IPSASB's stated purpose for the standard's introduction was to improve measurement guidance across IPSAS by:

    - Providing further detailed guidance on the implementation of commonly used measurement bases, and the circumstances under which they should be used;
    - Clarifying transaction costs guidance to enhance consistency across IPSAS;
    - Amending, where appropriate, guidance across IPSAS related measurement at recognition, subsequent measurement, and measurement-related disclosures.

2. IPSAS 46 *Measurement* provides new guidance in a single standard addressing how commonly used measurement bases should be applied in practice. It brings in generic guidance on fair value for the first time, and introduces current operational value, a public sector specific current value measurement basis addressing constituents' views that an alternative current value measurement basis to fair value is needed for certain public sector assets.

3. IFRS 13 is applied without adaptation in the FReM. The fair value measurement requirements in IPSAS 46 are drawn primarily from IFRS 13 *Fair Value Measurement*. The main differences between IPSAS 46 and IFRS 13 are:

    - IPSAS 46 provides guidance on historical cost, current operational value, cost of fulfilment and fair value. IFRS 13 only provides guidance on fair value.
    - IPSAS 46 requires an entity to apply the measurement disclosure requirements in the relevant IPSAS. IFRS 13 includes all disclosures about fair value measurement.

4. Current operational value is the amount the entity would pay for the remaining service potential of an asset at the measurement date. All other assets, that are held for their financial capacity, will continue to be measured at fair value as this faithfully represents the value to the public sector entity. The new measurement standard is quite clear in stating that assets held for their operational capacity should be measured at current operational value and assets held for their financial capacity are to be measured using fair value.

5. To reflect the unique characteristics of assets held in the public sector, current operational value measures assets in their existing use. Existing use is the way an asset, or group of assets, is used and generally reflects the policy objectives of the entity operating the asset. Current operational value can be determined directly be observing prices in an active market. In other cases, it is determined indirectly. For example, if prices are available for a similar asset, the current operational value of the entity's asset might need to be estimated by adjusting the current price of the similar asset to reflect the unique aspects of the entity's asset in its existing use and condition.

6. The FReM states that assets which are held for their service potential (i.e., operational assets used to deliver either front line services or back-office functions) should be measured at their current value in existing use. For non-specialised assets current value in existing use should be interpreted as market value in existing use which is defined in the RICS Red Book as Existing Use Value (EUV).

7. EUV is defined as 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.[6]

8. In comparison to IPSAS 46, there is no differentiation between assets held for operational capacity and those held for financial capacity in the FReM when considering non-specialised assets as a class. Current operational value places stronger consideration on the unique nature of public sector assets to help distinguish those assets held at operational capacity, rather than financial capacity. Current operational value focuses on the policy objectives of the entity operating the asset. Existing use value focuses on the transaction price between a willing buyer and willing seller in an arm's length transaction after proper marketing and where parties have acted knowledgeably, prudently and without compulsion and disregards potential alternative uses.

9. There are differences in applying EUV versus current operational value for when there is no active market. Both apply a replacement cost approach (DRC) but, under IPSAS, it is simpler in the sense that no alternative use is permitted and the same location applies.

10. It is worth noting that RICS have recently completed their own consultation on the definition of EUV. The outcome of this is still pending and HM Treasury will assess whether this captures the concept of current operational value.

11. Current operational value does not permit the income approach as a measurement technique. This differs to EUV which does. The reason is that current operational value is seen as a replacement cost (if no market data exists). IPSASB was of the view that an income approach would most likely under-value an asset – such as social housing. This is, however, causing some problems with the leasing standard. Most leased assets will be held for their operational capacity which would then require one to adopt current operational value under IPSAS. Leased assets are valued using the present value of lease payments which is an income method and is not permitted to be used when applying current operational value. IPSASB will be reviewing this in due course.

[6] Red Book UK National Supplement (rics.org)