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 and HM Treasury have shared final proposals with the Board. This paper sets out transition and disclosure considerations. An Exposure Draft accompanies this paper for the Board to consider.
Impact on guidance:	New guidance will be issued for transition to the new regime (this guidance will be contained in the Exposure Draft).
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 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 principles of IPSAS 46 (Measurement) and 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 transition and disclosure considerations in this paper.**
Timing:	HM Treasury are presenting the Board with proposals on implementation and transition guidance, and an Exposure Draft of the proposed changes to the FReM, in the November 2023 FRAB meeting. This is with a view to finalising requirements by the end of financial year 23/24. HM Treasury are proposing 25/26 as the effective date of any changes to FReM guidance.

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.
2. At the single-item FRAB meeting (held in two parts – part 1 on 26th October 2023 and part 2 on 8th November 2023), HM Treasury set out final proposals for the valuation of non-investment assets for financial reporting purposes.
3. CIPFA are in support of the proposals that were presented to FRAB. HM Treasury will continue working with CIPFA to ensure any progression reflects consistency, where possible, across the public sector.
4. To develop these proposals, HM Treasury established a technical working group. The working group is made up of stakeholders from across the public sector, including preparers, valuers, standard-setting authorities, and users. Participants included: the FRC, CIPFA, ICAEW, RICS, and a range of government departments including DLUHC. HM Treasury also engaged extensively with the National Audit Office. All proposals were discussed in detail with the working group in an iterative fashion.
5. The proposals put to FRAB at the single-item meetings are set out in the table below, with the decision made:

Question put to FRAB (single item meeting Oct/Nov 2023)	Outcome
1. Do you agree with HM Treasury's proposal to introduce 'assets held at operational capacity', following the same definition as IPSAS 46, and removing 'networked assets', 'specialised assets', and 'non-specialised assets' as classes in the FReM?	The Board agreed.
2. Do you agree with EUV as the measurement base for the assets held at operational capacity, with DRC being a methodology of calculating EUV?	The Board agreed.
3. Do you agree with HM Treasury's proposal to move to historical (deemed) cost for intangible assets?	The Board agreed.
4. Do you agree with HM Treasury's proposal to have three processes for valuing assets in central government: • Septennial revaluations with annual indexation • A rolling programme of revaluations	The Board concluded that quinquennial revaluations with indexation would be preferable. HM Treasury to consult on the three suggested processes in the Exposure Draft.

• For non-property assets only, appropriate indices	
5. Do you agree with HM Treasury's proposal to align with the IPSAS 46 requirement not to consider alternative locations when valuing an asset using DRC? [i.e., assets valued using DRC would assume the same location they are currently situated.]	The Board agreed.
6. Do you agree with HM Treasury's proposal to implement changes to FReM guidance for 25/26?	The Board agreed with the proposal but acknowledged that this is dependent on transition requirements and so should be revisited post-consultation.

6. Note that FRAB had a number of other comments on clarifying the accompanying FReM guidance, which are addressed in the Exposure Draft that has been shared with the Board, alongside this paper. HM Treasury intend to publish the Exposure Draft in December 2023.
7. This paper set outs secondary issues regarding the proposed transition and disclosure guidance for the agreed proposals.
8. The analysis below has been discussed with the working group, who agree with the proposals and conclusions below.

Introduction of assets held at operational capacity and EUV being the measurement base for these assets - transition requirements

9. The HM Treasury view is that transition guidance is not required for these particular changes. This is because the underlying measurement base is not changing for these non-investment assets. Assets valued at DRC will continue to be valued at DRC, assets valued using a market approach will continue to do so etc.
10. The changes proposed in these areas are more clarifications of the current financial reporting requirements rather than changes in underlying accounting requirements.

Question for FRAB: Do you agree with HM Treasury's conclusion in respect of these changes?

Intangible assets - transition requirements

11. As noted above FRAB agreed with HM Treasury's proposal to account for intangible assets at historical (deemed) cost. This would involve the value of intangible assets at the date of transition (1 April 2025) being taken as historic deemed cost, and historic cost accounting applied thereafter.
12. Therefore, by definition, these changes would be applied prospectively only.

Question for FRAB: Do you agree with HM Treasury's conclusion in respect of these changes?

Retrospective or prospective application for the requirement to revalue quinquennially and not to consider alternative sites when valuing assets at DRC- transition

13. IAS 8 paragraph 19 requires changes in accounting policies to be applied retrospectively unless the relevant IFRS standard includes specific transitional provisions or retrospective restatement is impracticable (IAS 8 paragraph 23). Refer to **Annex 1** regarding changes in accounting policies vs changes in accounting standards.

14. HM Treasury are not arguing that retrospective restatement for the changes in respect of valuation frequency and alternative locations is impracticable. However, in HM Treasury's view, the costs of retrospective restatements would outweigh the benefits and would be arguably unnecessary for users of the financial statements.

15. **Therefore, in respect of the requirement to revalue assets on a quinquennial basis with indexation in intervening years and not to consider alternative locations when valuing assets at DRC, the HM Treasury proposal is that entities shall apply these changes prospectively from 1 April 2025. Entities shall not restate prior year comparatives as a result of these changes.**

16. For the avoidance of doubt, entities do not need to professionally revalue all assets in 2025/26 to implement these changes. Rather, there would be a phased approach with transition occurring at the point of an entity's next revaluation date on/after 1 April 2025. For example: An entity holds a building on their SoFP valued at DRC and an alternative location is assumed. This was last professionally revalued on 1 April 2023. The next 5-yearly revaluation would be on 1 April 2028, which is 5 years from the last valuation, and would use the asset's current location for the valuation. This approach ensures the financial reporting changes are applied in a phased way over time, and avoids operational challenges of large numbers of entities all undertaking new revaluations in the same year.
17. As noted in Chapters 2 and 3 of the Thematic Review of Non-Investment Asset Valuations for Financial Reporting Purposes, use of asset valuation data for strategic decision making is limited for a variety of reasons. As such revaluing all assets using the new requirements on 1 April 2025 may not be necessary from a financial management perspective.

18. A key purpose for making these changes is to make the financial reporting regime more straightforward and easier to comply with; as noted in paragraphs 3.9 and 3.11 of the non-investment assets Consultation Paper, the current reporting requirements in respect of non-investment assets are considered burdensome by some. Requiring entities to retrospectively restate their financial statements for these changes may make the financial reporting regime more onerous in the short term and costly compared to the benefits.
19. HM Treasury is aware there are risks to this approach. A key risk being that, at a point in time, entities may have some assets valued based on their current location and other assets valued based on an alternative location. However, this is a short term transition risk and would be eliminated in central government from 1 April 2030 onwards (5 years from 1 April 2025), at which point all assets would be valued based on their current location.
20. Although valuing assets using different assumptions may not appear immediately straightforward to users of the accounts, any confusion should be limited to this single assumption and can be explained in an understandable way by reporting entities (please refer to the disclosure section below).
21. Additionally, the application of changes in accounting policies prospectively is not without precedent in IFRS; IFRS 13 was applied prospectively when it became effective (IFRS 13 paragraph C2). HM Treasury does accept that the prospective application of IFRS 13 was not phased in the way HM Treasury are proposing for the non-investment assets accounting requirement changes.

22. High quality financial reporting is also maintained under the proposed prospective application. Assets in scope of these changes will continue to be held on the SoFP at current valuation, with appropriate depreciation and impairment charges reported in the SoCNE,

and therefore still achieves a high level of transparency and accountability over how the reporting entity is managing their asset base.

23. For these reasons, the HM Treasury view is that applying these accounting policy changes prospectively, and in a phased way, achieves the right balance between the cost of complying with these changes and maintaining high quality financial reporting.

24. The approach to indexation is discussed in the next question.

Question for FRAB: Do you agree with HM Treasury's proposal for the changes in requirements for assets to be revalued every 5 years and not to consider alternative locations when using DRC to be applied prospectively only, and phased as described above?

Approach to indexation - transition

25. The HM Treasury proposal is for entities to revalue their assets using one of the following processes: 1) 5-yearly revaluations with indexation in intervening years, 2) a rolling programme of revaluations with indexation for assets not revalued in a given year, 3) appropriate indices for non-property assets.

26. For 3) appropriate indices for non-property assets, this process has been in the FReM for some years and HM Treasury are not proposing any changes in respect of this process. Therefore, no transition guidance is required for this valuation process.

27. As at the date of transition (1 April 2025) entities may be in a different position with their indexation. For example, an entity may have had their last full revaluation on 1 April 2022 with no indexation in intervening years as the impact was immaterial. There could be a question as to whether there needs to be a catch-up adjustment for entities who have not indexed/ performed a desktop valuation etc since their last full revaluation.

28. FReM paragraph 10.1.1 provides appropriate detailed guidance to preparers. It states: '*In considering how best to apply the valuation requirements of IAS 16 so as to ensure that the Statement of Financial Position gives a true and fair view of the value of the assets at the reporting date, entities should consider the following guidance on property and non-property assets.*'

29. This guidance should remain in the FReM at least up to 31 March 2025. Therefore, as at 31 March 2025 it should be fair to assume that the carrying value of all assets on the SoFP are true and fair.

30. On the assumption that value of all assets on the SoFP on 31 March 2025 are true and fair, the HM Treasury view is that there should be no need for any catch-up adjustments in 2025-26 for indexation. The value of the assets brought forward into 2025-26 are materially correct so their values do not need to be adjusted.

31. The HM Treasury proposal is for annual indexation to be applied prospectively only - entities do not need to apply indexation retrospectively.

Question for FRAB: Do you agree with HM Treasury's proposal for annual indexation to be applied prospectively only?

Disclosure

32. Below is draft narrative entities may use in their 2025-26 ARAs to explain the change in accounting policy. Refer to **Annex 1** regarding changes in accounting policies vs changes in accounting standards. The wording <u>would not</u> be mandatory, which will allow entities to tailor their narrative on this accounting policy change to their own specific circumstances.

33. **Suggested narrative:** *From 1 April 2025 HM Treasury changed the requirements in the Government Financial Reporting Manual (FReM) in respect of revaluations of property, plant and equipment. Where entities do not have a rolling programme of revaluations in place and/ or the assets are not non-property assets subject to indexation, entities revalue their assets every 5 years with indexation in intervening years. For assets valued using the Depreciated Replacement Cost (DRC) methodology, entities are now required to value their assets based on their current location and not to consider alternative locations. These changes are applied prospectively in line with the transition requirements published by HM Treasury.*

34. HM Treasury have not identified any further areas where disclosure guidance is required.

Question for FRAB: Do you agree with HM Treasury's conclusions?

IFRS 16 guidance

35. Chapter 5 of the non-investment assets consultation paper states that additional guidance may be needed for leased assets accounted under IFRS 16 for these proposed changes. Entities who responded to the consultation paper agreed additional guidance may be needed[1].

36. HM Treasury have considered how the proposed changes to the financial reporting framework in respect of non-investment assets interacts with IFRS 16.

37. The relevant guidance in the FReM on valuation of RoU assets is section 10.2. On review of section 10.2 HM Treasury have not identified any changes which need to be made as a result of the HM Treasury thematic review of non-investment assets.

Question for FRAB: Do you agree with HM Treasury's conclusion?

[1] FRAB 150 (06) paragraph 108

Annex 1: Change in accounting policy vs change in accounting standards for the proposed changes to the financial reporting framework

38. There have been a few questions raised by FRAB members regarding whether the proposed changes should be treated as a change in accounting policy or a change in accounting standards. IAS 8 includes the following definitions:

***Accounting policies* are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.**

***International Financial Reporting Standards (IFRSs)* are Standards and Interpretations issued by the International Accounting Standards Board (IASB). They comprise:**

(a) International Financial Reporting Standards;

(b) International Accounting Standards;

(c) IFRIC Interpretations; and

(d) SIC Interpretations.[1]

39. IAS 8 paragraph 14 states:

An entity shall change an accounting policy only if the change:

(a) is required by an IFRS; or

(b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

40. Given the definitions in IAS 8 extracted above and the requirements of IAS 8 paragraph 14, it would appear that the proposed changes to the accounting requirements for non-investment assets are a change in accounting policy and a change in accounting standards. This is because the underlying requirements of the accounting standards in the FReM are being changed, which also changes the accounting policies entities apply. As stated in places in IAS 8 (for example IAS 8 paragraph 19) changes in accounting policies can result from the initial application of an IFRS, which itself is a change in accounting standards. HM Treasury are therefore of the view that the concepts of a change in accounting policy and change in accounting standards are not necessarily mutually exclusive.