

# Financial Reporting Advisory Board

## Non-investment assets valuation update

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| <b>Issue:</b>  | As part of the non-investment asset valuations workstream, the Board have been discussing whether modern equivalent asset (MEA) principles should apply to land in the depreciated replacement cost (DRC) valuation. This paper provides an update on HM Treasury's position, following further research, including a summary of views from a technical working group meeting held to discuss this issue.  |
| <b>Impact on guidance:</b>   | <p>As a result of further research and discussions, including with the technical working group (TWG), HM Treasury have concluded that the existing MEA principles should continue to apply to DRC valuations. Consequently, HM Treasury do not expect to make any changes to the FReM in this respect. [N.B. the FReM text for removing the consideration of alternative locations in a DRC valuation has already been agreed].</p> <p>With regard to implementation of the previous decision to remove the option to consider alternative locations in a DRC valuation, HM Treasury proposes that this should apply from 2028/29 in order to allow time for implementation and the consequences to be reflected in budgets.</p> |
| <b>IAS/IFRS adaptation or interpretations for the public-sector context?</b> | As above. The FReM text for removing the consideration of alternative locations in a DRC valuation has already been agreed by the Board.   |
| <b>Impact on WGA?</b>  | Yes – WGA will be expected to incorporate the changes made within the Whole of Government Accounts.  |
| <b>IPSAS compliant?</b>  | No – HM Treasury understand certain valuation requirements in IPSAS differs from the FReM.   |
| <b>Impact on Estimates/budgetary regime?</b>                                 | The estimates and budgetary impact of the changes will be included in HM Treasury's Consolidated Budgeting Guidance (CBG).   |
| <b>Alignment with National Accounts</b>                                      | N/A- no changes made which impact alignment between National Accounts and departmental accounts.   |
| <b>Recommendation:</b>   | <p>The Board note the conclusion HM Treasury have reached on the future application of MEA and provide any comments on the rationale.</p> <p>The Board agrees to HM Treasury's proposal to remove the requirement to consider alternative locations in a DRC valuation in the 2028-29 FReM.</p>  |
| <b>Timing:</b>   | HM Treasury propose to implement no longer considering alternative locations in a DRC valuation in the 2028-29 FReM.   |

## DETAIL

### *Background*

1. At FRAB 153 HM Treasury presented updated FReM text, showing the updates relating to accounting for PPE. Refer to [this paper](#), page 25 paragraph 10.1.13c) which states 'entities shall value the asset based on its current location and not consider alternative locations'.
2. The Board discussion revealed that the proposed language was being interpreted differently by members:
  - a. Some FRAB members interpreted this paragraph as entities should value an asset in its current location, but can have a smaller modern equivalent asset (MEA) for the land.
  - b. Other FRAB members interpreted this paragraph as requiring entities to value the exact area of the current site occupied, meaning MEAs for land could not be used.
3. Subsequently, HM Treasury presented an out-of-meeting paper to the Board, outlining whether MEA principles should still apply to land within a depreciated replacement cost (DRC) valuation. The Board did not reach a consensus on whether MEA principles should apply to land or not.
4. At FRAB 155 in March 2025 HM Treasury set out our workplan for exploring this issue in more detail. A technical working group (TWG) was set up to discuss the questions set out in this paper: [FRAB\\_155\\_08\\_Non-investment\\_asset\\_valuations\\_workstream\\_update.pdf](#).
5. This paper updates the Board on the outcomes from the TWG meeting and HM Treasury's recommendation.

### *Overview of FReM requirements*

6. The detailed FReM requirements and RICS guidance can be found in the [annex](#) to this paper. In summary:
  - a. A key measurement principle is that it is the cost of replacing the service potential to meet the needs of the entity's existing operations which is being measured.
  - b. The FReM uses the RICS definition of Existing Use Value (EUV) and depreciated replacement cost (DRC).
  - c. Alternative uses and any factors causing market value to differ from the cost of replacing the service potential are excluded from the calculation of EUV.

7. In the private sector application of DRC involves a calculation of the cost of replacing the building and the site. [The hypothetical buyer would also purchase the least expensive site to provide their services]. However, the Board has agreed that the FReM will no longer allow alternative site valuations.
8. As the MEA approach involves valuation on the basis of how the service would be provided based on current approaches to service provision rather than how services are actually configured on a given site, the modern equivalent land requirement could be smaller than the actual site an entity occupies.

### ***Outcomes from TWG meeting on land valuation***

9. The TWG highlighted the valuation principle in the FReM means entities are measuring the cost of replacing service potential of an asset rather than the actual asset. This is an established principle that has been in place for several years, and which the Board has decided to retain in the FReM as a basis for valuation.
10. General consensus from the TWG meeting held in October 2025 was that MEA principles should still apply to land if EUV remains the measurement basis and DRC is used as the valuation methodology for the given asset.
11. The TWG commented that keeping consistency between the valuation of land and buildings is important for users' understandability of public sector asset valuations and compliance with the measurement principle of measuring the least cost of replacing the service potential.
12. The TWG felt users would not understand why service potential is delivered with a smaller building but exactly the same land. They also felt users would find it confusing if a single property were to be valued under two different measurement principles.
13. Considering the relatively unique users for central government accounts (Parliament), what is understandable is 'how much to replace this hospital, both land and buildings', The TWG felt that a DRC valuation provides the best answer to this question.
14. Members also commented that if the Board accepts the cost of replacing the service potential of an asset as the valuation basis, then it is important to remain consistent with RICS principles. This is because valuers and preparers understand and are familiar with existing RICS guidance and the guidance has been working well for some years.

### ***HM Treasury analysis of FReM requirements and FRAB member challenges***

15. The FReM uses the RICS guidance, definitions and application of EUV and DRC to assets held for their operational capacity. In respect of DRC, the key principle is that an entity is measuring the least cost of replacing the service potential of an asset. This means the MEA used to calculate the least cost of replacing the service potential of an asset can:
  - a. Have a smaller building than the entity actually occupies; and
  - b. Have a smaller land footprint than the entity actually occupies.

16. HM Treasury highlights that the application of MEA to both land and buildings has been part of the current valuation regime in the FReM for some time. This is not a new concept being introduced.
17. HM Treasury also highlight that, with the decision to no longer allow DRC valuations to be based on alternative sites (a decision made by the Board on the basis that valuing an alternative sites required too many assumptions about policy decisions that have not yet been made), there will be many valuations where the MEA land in a DRC valuation will be much closer to the size of the actual land occupied.

### Challenge 1: Land cannot be reconfigured, therefore MEA cannot apply to land

18. FRAB members have commented that MEA should not apply to land as you cannot reconfigure land in the same way you can a building.
19. Under the EUV basis of valuation and DRC methodology incorporated in the FReM, it is the cost of replacing the service potential which is being measured and included on an entity's SoFP rather than the actual asset. This principle applies equally to both land and buildings. Consequently, the fact you cannot theoretically reconfigure land in reality does not prevent MEA being applied to both land and buildings in a DRC valuation, with the measurement principle being the cost of replacing the service potential.

### Challenge 2: Applying MEA to land leaves some land not valued

20. FRAB members have also commented that, if MEA is applied to land then this leaves some land not valued and not included on an entity's SoFP. Using the RICS example in the [Annex](#) to this paper, if an entity has 5 hectares of land but the MEA is 3 hectares of land, this could be viewed as leaving 2 hectares of land not valued.
21. As noted above it is the cost of replacing the service potential of an asset which is being measured rather than the actual asset. Including the 2 hectares of land in the asset valuation would not represent the least cost of replacing the service potential of an asset, which is the measurement principle in the FReM.
22. Using the 5 hectares-3 hectares example, HM Treasury do not consider that the remaining 2 hectares should be valued under IFRS 13 or IFRS 5. This is because:
  - a. The 2 acres of land is currently needed for its operational capacity. This land would not meet the criteria set out in IFRS 5 paragraph 8 as being held for sale as the appropriate level of management is not committed to a plan to sell the asset, there is no active programme to locate a buyer for the land, and the 2 hectares are not currently being actively marketed for sale.
  - b. This land would therefore not meet the definition of surplus land per FReM paragraph 10.1.12 as the land is currently being used to deliver services.
23. HM Treasury also highlight that if an entity does currently have surplus land that is not being used for its operational capacity, and is currently available for another use, this would be separately valued, rather than being included in the MEA valuation.

### Challenge 3: Land and buildings are accounted for separately per IAS 16, therefore MEA does not need to apply consistently to land and buildings

24. IAS 16 para 58 states land and buildings are separable assets and accounted for separately, even if they are acquired together. HM Treasury agrees land and buildings are accounted for separately as they have different accounting policies for transactions like depreciation and impairments.
25. However, in HM Treasury's view IAS 16 paragraph 58 does not necessarily preclude MEA being applied to land and buildings if the measurement principle is the least cost of replacing the service potential of an asset.
26. Application of MEA to both land and buildings is consistent with RICS guidance, which is the measurement guidance the FReM has incorporated into the central government financial reporting regime.
27. The application of MEA to both land and buildings was discussed at the TWG meeting referenced above, and it was generally agreed that MEA to both land and buildings is most understandable to users of the accounts in the context of the measurement principle being the least cost of replacing the service potential.

### Conclusion

28. As noted above, there was limited support amongst the TWG for no longer consistently applying MEA principles between land and buildings.
29. As stated at the outset of the [thematic review of non-investment asset valuations](#), the purpose of the 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.'*
30. The thematic review has not conclusively identified:
  - a. That applying MEA to land in a DRC valuation is a significant challenge to preparers and valuers; and
  - b. That moving away from the current valuation regime of using the RICS definitions and guidance on EUV and DRC and no longer applying MEA to land would alleviate the challenges identified.
31. Consequently, HM Treasury conclude that the current approach in the FReM of being able to apply MEA to land should remain.

### ***Timing of implementing no longer considering alternative locations in a DRC valuation***

32. While the decision to remove the requirement to consider alternative locations when developing the MEA in a DRC valuation has already been made, the financial year in which this change is made has not yet been agreed.

33. HM Treasury acknowledges that this change will be significant for some types of entities, particularly in the NHS where we understand the MEA is sometimes in a different, less expensive location. There are also instances where an entity has service delivery buildings in multiple locations, but the MEA is based on a single merged location.
34. We have engaged with RICS, and they will also need time to update their guidance (which is used by the valuation profession) for this change.
35. As a result, the HM Treasury view is that entities should have 2 full financial years lead time to implement these changes. This means implementing this change in the 2028-29 FReM.
36. As previously agreed, this change will be made prospectively with no restatement of prior year comparative values. The change will also be implemented from an entity's next valuation. For example, say an entity is not due a quinquennial revaluation in 2028-29, but the next valuation is due in 2030-31. Though the change to the FReM is made in 2028-29, the transition requirements mean the entity would apply the change to no longer consider alternative locations in their DRC valuation in 2030-31.

***Recommendations:***

37. That the Board confirm that the MEA principles will continue to apply to land in a DRC valuation.
38. That the removal of the option to use alternative sites in valuations is implemented in the 2028-29 FReM onward,

HM Treasury  
20 November 2025

## Annex 1: FReM and RICS guidance extracts

1. Paragraph 10.1.6 of the [2025-26 FReM](#) states asset which are held for their operational capacity should be valued using the Existing Use Value (EUV) basis of valuation as defined in the RICS Red Book.
2. The RICS Red Book UK National Supplement defines EUV 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.**' [UK-national-supplement\\_reissuedJan25.pdf](#), section VPGA6.
3. VPGA 6 in the RICS Red Book UK National Supplement also states the following: 'The underlying premise is that the value being measured is the present value of the in-situ asset's remaining service potential for the continued delivery of the existing operational function to which the asset is being put. This can be assumed to be equal to the amount required to replace that required service potential at least cost in a market transaction.' (para 4)
  - a. 'Service potential in the context of EUV is a measure of the property's potential to provide the service needs of the current occupier's existing operations, rather than the property's potential for use for any other purpose even if this does not need planning consent.' (Para 6)
  - b. 'EUV is the amount an entity would pay to replace, at least cost, the service potential that enables the continued operational delivery of the existing service function to which the property is being put. The current owner is included among those who constitute the market.' (Para 7)
  - c. 'Disregarding 'alternative uses' in the context of EUV means that the valuer should **disregard any uses, including those within the same planning use class, that would drive the value above that needed to replace the service potential of the property for the existing and continuing function to which it is being put.** In seeking to replace this potential at least cost, value arising from alternative uses or development potential irrelevant to that purpose is not to be reflected. The valuer should therefore ignore any element of 'hope value' for alternative uses that could prove more valuable.' (para 17)
4. Paragraph 10.1.13 of the 2025-26 FReM states that where Depreciated Replacement Cost (DRC) is used to value an item of PPE, entities and their valuers should have regard to the guidance contained in the most recent RICS Red Book.



5. The RICS Red Book defines DRC as: *'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.'*
6. As stated in the [RICS DRC guidance](#):
  - a. DRC is based on the economic theory of substitution, and involves one asset being compared with another. As there is no directly comparable alternative asset to compare to, the actual asset is compared with a modern equivalent asset (MEA). The underlying theory is that the potential buyer would not pay any more to acquire the asset being valued than the cost of acquiring an equivalent new one. (Paragraph 2.4)
  - b. When assessing the replacement cost the general principle is that the costs reflect those of a modern equivalent asset that offers an equivalent service potential to the actual asset. (Paragraph 6.1)
  - c. The gross replacement cost of the asset comprises the cost of replacing the land and any improvements to the land. (Paragraph 6.4).
  - d. When considering the site of the MEA, *'the fundamental principle is that the hypothetical buyer for a modern equivalent asset would purchase the least expensive site that would realistically be suitable and appropriate for its proposed operations and the envisaged modern equivalent facility'*. (Paragraph 7.1)
  - e. When considering the site of the MEA, entities also need to consider whether they would require a site of similar size. *'If, for example, three hectares are now sufficient to provide the same service, the modern equivalent site will be three hectares, even if the actual site in operational use is five hectares. Unless there are areas of clearly identifiable vacant land at the actual site, no surplus land will be present to be valued'*. (Paragraph 7.3)
  - f. Entities should also consider any vacant land at the actual site to determine whether it is surplus or being used for its operational capacity. If not used for its operational capacity, it is not included in the DRC valuation. Land categorised as surplus is valued as a separate asset and not under DRC. (paragraph 7.5).