



# NON-INVESTMENT ASSET VALUATION FOR UK GOVERNMENT FINANCIAL REPORTING

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ICAEW welcomes the opportunity to submit evidence to HM Treasury's consultation dated 14 December 2023 on *Non-investment Asset Valuation for Financial Reporting Purposes* (the Exposure Draft), details of which are available from this [link](#).

## Support HM Treasury aim of high-quality financial reporting

- We support HM Treasury's aim to balance high-quality financial reporting with the costs involved.
- We concur with the creation of a new class of 'assets held for operational capacity'.
- We also concur with the use of historical (deemed) cost for intangible assets.
- Flexibility should be granted with regards to the valuation cycle as it may be more cost effective to value some assets more frequently than the proposed five-year cycle.

## A missed opportunity to simplify financial reporting in the public sector

- We have reservations about the application of depreciated replacement cost (DRC) for assets where there is no observable market, such as for infrastructure assets.
- Subjectivity in DRC calculations hampers the reliability of reported asset balances.
- Applying DRC for local authority assets could negatively impact timeliness of reporting.
- HM Treasury acknowledge in paragraph 3.5 that current values are not used for strategic decision making which makes historic cost an attractive alternative.

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This response has been prepared by ICAEW's Public Sector team, part of Reputation and Influence, in consultation with ICAEW's Public Sector Advisory Group. ICAEW's Public Sector team supports members working in and with the public sector to deliver public priorities and sustainable public finances, including over 12,000 in ICAEW's Public Sector Community. ICAEW engages with policy makers, public servants, and others to promote the need for effective financial management, audit and assurance, financial reporting and governance and ethics across the public sector to ensure public money is spent wisely.

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## INTRODUCTION

### We welcome HM Treasury's exposure draft on non-investment assets and subsequent amendments to the Financial Reporting Manual (FReM)

1. ICAEW welcomes the opportunity to respond to this exposure draft (ED) on non-investment asset valuation. How assets and liabilities are measured is a critical component of accounting and financial reporting and can change the shape of the balance sheet. Valuations can also have a noticeable impact on the complexity, for both reporting and auditing, which can impact the timeliness of publishing audited annual reports.
2. ICAEW responded to HM Treasury's *Thematic Review of Non-investment Asset Valuations for Financial Reporting Purposes* issued in March 2023 which can be accessed using this [link](#).
3. In that submission, we argued against extending the use of DRC because it is a highly subjective measurement technique, which can be difficult to understand by users of the accounts, and in our view can lead to inappropriately high valuations for some assets, such as the railway network. This remains our view.
4. We recognise that HM Treasury has elected to adopt the DRC valuation method for assets where no observable market exists. We would like to place on record that this is not our preferred outcome, since we believe the historical (deemed) cost valuation method would be more appropriate. However, in order to be as constructive as possible, our response to the consultation will reflect HM Treasury's decision.
5. For questions on this submission please contact our Public Sector team at [representations@icaew.com](mailto:representations@icaew.com) quoting REP 19/24.

## KEY POINTS

### Support HM Treasury's aim of high-quality financial reporting

6. We fully support HM Treasury's aim to "balance the need for high quality financial reporting with the costs associated with the regime and the benefits to users".
7. We concur with the creation of a new asset category of 'assets held for their operational capacity' to replace the existing categories of 'network assets', 'specialised assets' and 'non-specialised assets'. This will simplify the approach to accounting for the majority of tangible fixed assets owned by public bodies, as well as reducing subjectivity in asset categorisation and what that means for measurement in the statement of financial position.
8. We understand HM Treasury's proposal to revalue assets on a five-year valuation cycle on cost grounds but recommend some discretion here as it may be more cost effective to value some assets on a more frequent basis.
9. Financial reporting is only of high-quality if it provides decision-useful information and can be used to hold those charged with governance to account. However, HM Treasury acknowledge in paragraph 3.5 that current values are not used for strategic decision making. Government departments are held to account on the policies that operational assets help deliver rather than the value of the assets themselves.

### A missed opportunity to simplify financial reporting in the public sector

10. As expressed in our consultation response issued in May 2023 on non-investment asset valuations, we have reservations about the application of DRC for assets where there is no observable market, such as for infrastructure assets.
11. The high degree of subjectivity in DRC calculations hampers the reliability of reported asset balances, risks inconsistency of valuation between similar assets, can overvalue assets, and focuses preparers, auditors and regulators on numbers that are sometimes perceived to be of limited relevance to users. In some circumstances, additions to fixed asset are

immediately impaired on technical grounds when applying DRC, which can obscure the stewardship role of financial statements, hampering accountability.

12. We are also concerned that applying DRC for local authority network assets could negatively impact the timeliness of reporting, a particular issue in the context of the ongoing crisis in local authority financial reporting and audit. Whether assets are recorded at historical cost or use a current valuation, understanding the condition of assets and the accuracy and completeness of asset records is essential to good public financial management. Changing the measurement basis used for recording assets will not address weaknesses in recordkeeping identified in some public bodies.

### Reminder of the proposed changes to asset valuations

Existing asset category	Existing measurement	2023 Consultation Paper proposed measurement	Exposure Draft proposed asset category	Exposure Draft proposed measurement
Networked assets	DRC	DRC	Merged to become a new asset class: 'Assets held for their operational capacity'	Current value in existing use (EUV), defined as market value in existing use (if an observable market exists) or DRC (if not).
Specialised assets	DRC	Historical (deemed) cost		
Non-specialised assets	Market value in existing use	Fair value		
Heritage assets	Current value like other IAS 16 assets, if not available then historic cost	No change proposed	Heritage assets	No change proposed
Social housing	EUV	EUV	Social housing	EUV
Surplus assets	Fair value	Fair value	Surplus asset	Fair value
Intangible assets	EUV or historic cost	Historical (deemed) cost	Intangible assets	Historical (deemed) cost

### ANSWERS TO SPECIFIC QUESTIONS

#### Question 1

***Do you agree that HM Treasury should introduce a new asset class – assets held for their operational capacity – to replace the existing asset classes ‘networked assets’, ‘specialised assets’ and ‘non-specialised assets’ for valuation purposes. If so, why? If not, why not, and what alternatives do you propose?***

13. Yes, we support the creation of this asset class.
14. We agree with the Exposure Draft that there are instances where it is difficult to determine if an asset is specialised or not. The differentiation would have been especially important if the original proposal had gone ahead to measure networked assets at current value and non-specialised assets at fair value.
15. Having decided to apply a current valuation basis, the key driver on what technique to apply to obtain that valuation is not the relevant asset class but whether or not an observable market exists. In our opinion, the proposal to merge the three asset classes should enable financial statement preparers to focus on applying the right valuation technique to provide a current valuation.

16. The introduction of operational capacity, taken from the International Public Sector Accounting Standards (IPSAS), is a new term with which some users may not be familiar. Although the Exposure Draft is not explicit, we recommend that HM Treasury add some guidance on what this means in practice.
17. We recommend adopting the IPSAS definition ([IPSASB Conceptual Framework](#) paragraph 7.3): Operational capacity – the capacity of the entity to support the provision of services through physical and other resources.

### **Question 2**

***Do you agree that the introduction of a new asset class – assets held for their financial capacity – is not required and should not be incorporated into the FReM? If so, why? And if not, why not?***

18. We agree with HM Treasury that there is no need to introduce a separate category of ‘assets held for their financial capacity’.
19. Investment properties would fall within such a category, but we concur with the conclusion implied by the Exposure Draft that such assets should continue to be accounted for under IAS 40 *Investment Property*.
20. Similarly, we concur with continuing to measure non-current assets held for sale and discontinued operations in accordance with IFRS 5.
21. While there are some other non-financial public assets in the UK that could be considered to be held for their financial capacity, following the closure of the Magnox nuclear power plant fleet we are not aware of any significant assets where there would be a significantly different accounting outcome through the creation of such a category.

### **Question 3**

***Do you agree that the EUV measurement basis should be maintained? If so, why? If not, why not? Would you support the introduction of COV as an alternative?***

22. We agree that EUV measurement basis should be maintained for two reasons:
  - a. The COV measurement basis does not permit the income approach as a valuation technique, which is an unnecessary restriction in our view; and
  - b. RICS has created additional guidance on the application of EUV with which the valuation community is familiar.

### **Question 4**

***Do you agree that this Exposure Draft provides sufficient guidance and context regarding the valuation approach for Right-of-Use assets, and that no changes are required to Section 10.2 of the FReM in light of the other changes to the valuation of non-investment assets being proposed? If so, why? If not, why not?***

23. The FReM only provides additional guidance on peppercorn leases which in our view do not meet the definition of a lease contract which is the right to use an asset in exchange for consideration of approximately equal value. We believe that peppercorn leases are grants in substance.
24. Right of use (ROU) assets will predominantly be held for their operational capacity and we question the suitability of fair value measurement basis, which is not entity specific and is an exit value.
25. The guidance for peppercorn leases on p72 of the FReM states that initial measurement of the ROU asset is at current value in existing use or fair value. We discount fair value due to the reasons noted in the above paragraph. Subsequent measurement of ROU assets for peppercorn leases, according to paragraph 10.2.3, is also current value in existing use.
26. Paragraph 10.2.4 explains that current value in existing use is the ‘full replacement cost of the right of use asset’ and that ‘this valuation should reflect the terms and conditions of the

lease giving rise to the ROU asset'. The lease liability for peppercorn leases is measured in accordance with IFRS 16 and is the present value of contractual lease payments.

27. The guidance on p72 states that the difference in value of the ROU asset and the liability should be shown as income. This seems to indicate that HM Treasury's intention is to show the ROU asset at market rates as though the truncations were on a commercial basis.
28. In our view the guidance on peppercorn leases should be much clearer regarding the initial measurement of the ROU lease and what the subsequent measurement is. If the ROU asset should be measured at a market rate (commercial basis) then this would put a burden on the recipient of a peppercorn lease. IPSASB's leases standard states that if it is too costly to determine the market rate for concessionary leases then the lessee can in effect show the ROU asset and the lease liability at the same value – you would then not be able to show the grant/subsidy element, reducing transparency.
29. At best the current guidance does not provide the user of financial statements with the value of the concession/grant (difference between ROU asset and lease liability), at worse, the ROU asset would need to be written down from a market value to a zero or nominal replacement cost.

### **Question 5**

***Do you agree that the requirement to consider alternative locations when valuing an asset using DRC should be removed from the FReM? If so, why? If not, why not?***

30. Yes, we agree with the proposal to remove alternative locations from the DRC valuation to help simplify this methodology. While in theory it might be helpful to separate location from the other features of a particular asset, it is rarely helpful in practice.

### **Question 6**

***Do you agree with HM Treasury's proposed three processes for asset valuations? If so, why? If not, why not and what alternatives do you propose?***

31. We agree with the three processes for asset valuations which should avoid a large number of government assets requiring valuations over a short period of time, putting strain on the valuation experts and thus potentially delaying the financial reports.
32. We do not agree with prescribing a five-year valuation cycle. In our view there is no public sector reason to depart from IAS 16 which provides a range of between three and five years. For some assets it may be desirable and more cost effective to have a valuation cycle that is shorter than five years. Similar to the proposals for indexation, we believe that entities should have a choice in the valuation frequency.

### **Question 7**

***Do you agree with HM Treasury's proposal for indexation to be applied to property assets each year in-between full revaluations? If so, why? If not, why not and what alternatives do you propose?***

33. Yes, we agree with the proposals for indexation to be applied each year in-between full revaluations, especially if a strict five-year valuations cycle is adopted.
34. Applying an appropriate index should result in a more accurate carrying value in the years where a full revaluation is not taking place. The accuracy of these values when applying DRC can be debated however, since these valuations can be subjective. Nevertheless, if indexation helps auditors gain comfort regarding the carrying values being true and fair, avoiding the need to demonstrate that carrying values are materially the same as current values, then we support the proposals.



**Question 8**

***Do you agree that it is not appropriate for HM Treasury to prescribe indices but that it should provide guidance on what indexation is and common indices to help entities implement changes? If so, why? If not, why not and what alternatives do you propose?***

35. Yes, on the whole we believe preparers should be able to use their discretion to adopt indices that are the most appropriate for their particular assets, for example by using regional indices rather than national ones, or where there are specific circumstances that would make following a prescribed index inappropriate. We believe that this approach would result in the best quality output.
36. However, we also concur with the need to provide guidance to preparers to assist them in choosing appropriate indices and to minimise the use of very different (or conflicting) indices for similar assets. We therefore agree with HM Treasury's approach in trying to balance a more prescriptive approach, which would simplify the accounts preparation and audit process, with allowing preparers to adopt bespoke indices tailored to their needs.
37. We believe HM Treasury should keep this under review to ensure there is no unnecessary diversion from common indices that could be applied. From an auditing point of view, the more bespoke an index, the more risk and additional audit work required.

**Question 9**

***Do you agree with HM Treasury's conclusion that the valuation cycle should be 5 years (with the exception of non-property assets where appropriate indices are applied)? If so, why? If not, why not and what alternatives do you propose?***

38. We do not agree with prescribing a five-year valuation cycle as set out in our response to question seven above.
39. Applying an index in between a five-year valuation cycle will not always reflect localised issues that could affect the asset values. It would seem sensible to allow some discretion with regards to valuation frequency; we would support a mechanism to override an index where there is good reason that a local valuation is materially different.

**Question 10**

***Do you agree with the change in wording to the FReM adaptation for IAS 38 Intangibles, where HM Treasury will be mandating a historical cost model (and withdrawing the revaluation option)? If so, why? If not, why not and what alternatives do you propose?***

40. Yes, we agree with the change in the wording to the FReM adaptation for IAS 38 Intangibles.

**Question 11**

***Do you agree that intangible assets should be measured at historical (deemed) cost, with the value of intangible assets at the date of transition being taken as historical (deemed) cost, and historical cost accounting applied thereafter? If so, why? If not, why not and what alternatives do you propose?***

41. Yes, we agree with this recommendation to require intangible assets to be valued at historic (deemed) cost. While there may be circumstances in which fair values might be potentially appropriate for certain intangible assets, these are not material to the UK public sector and we see the benefits of adopting a consistent approach across government as a matter of accounting policy.

**Question 12**

***Do you agree with the proposed effective date of financial year 2025-26 for the changes? If so, why? If not, do you think the proposed effective date should be financial year 2026-27? If so, why? Are there any significant operational challenges you consider might be***

***encountered during the implementation of this proposed approach to the valuation of non-investment assets?***

42. Yes, we agree with the proposed effective date of financial year 2025-26.
43. Referring to the table on p3 of our response which shows current valuation methodology vs final proposals, it is clear that the proposed changes are not that far reaching. Therefore, the effective date seems reasonable.

**Question 13**

***Do you agree with HM Treasury's proposals for transition described above? If so, why? If not, why not and what alternatives do you propose.***

44. Yes, we agree with the transition plan as it strikes the right balance between ease of adoption and maintaining high quality financial reporting. Furthermore, the proposals are not far reaching and for many the changes will have minimal impact.

**Question 14**

***Do you agree with HM Treasury's conclusions on disclosure guidance? If so, why? If not, why not and what alternatives do you propose.***

45. We agree with the disclosure guidance, except for the five year valuation cycle, and agree not to make this mandatory.

**Question 15**

***Do you agree with HM Treasury's proposed update to Chapter 10 of the FReM to introduce the concept of assets held for their operational capacity, remove the specialised/ non-specialised asset split from the FReM, and add additional guidance from IPSAS 45 on how to identify as asset held for its operational capacity? If so, why? If not, why not and what alternatives do you propose.***

46. We agree with the current wording that is suggested on p20 of the ED but have some recommendations to make additional changes.
47. We recommend that paragraph 10.1.4 in the FReM is shortened to only include the first paragraph as shown on p20, ending in 'which is defined in the RICS Red Book as Existing Use Value (EUV)'.
48. Then a new paragraph should be introduced, 10.1.5, which should start by stating that when there is no observable market, current value in existing use is obtained by applying DRC valuation techniques.
49. Furthermore, we recommend re-ordering the paragraphs taken from IPSASB so that the next paragraph in 10.1.5 starts with 'In some cases, it may not be clear . . .', which is then followed by 'In certain circumstances, an item of property, . . .'.
50. Lastly, we recommend removing 'front line' from the explanation of what operational capacity means as that is unnecessary, as operational assets are used to deliver services more generally and would then remove the need to determine if a service is front line or not.

**Question 16**

***Do you agree with HM Treasury's proposed update to the existing adaptation of IAS 16 covering measurement bases to introduce the concept of assets held for their operational capacity and remove the specialised/ non-specialised asset split from the FReM? If so, why? If not, why not and what alternatives do you propose.***

51. It seems counterintuitive to describe current value in existing use as market value for existing use. Not only is market value no longer a measurement basis in the conceptual framework but more importantly, many assets held for their operational capacity will not actually have an observable market. Where this is the case, DRC is applied.

52. We feel that the FReM would be better placed to introduce a formal hierarchy covering model, basis and technique.

Model = historic cost or current value

Basis = historic cost or for current value, fair value or current value in existing use

Technique (current value only) = market, income (ie cash flow) or cost (DRC) approach

53. There is an example of this diagram in IPSASB's literature but we would be happy to assist further with this.

#### **Question 17**

***Do you agree with HM Treasury's proposed adaptation of IAS 38 to mandate measuring intangible assets using the cost model after initial recognition? If so, why? If not, why not and what alternatives do you propose.***

54. We agree with the proposals to measure intangible assets using the cost model.

#### **Question 18**

***Do you agree with HM Treasury's proposed adaptation of IAS 16 paragraph 34 and the changes to FReM paragraphs 10.1.1 and 10.1.2? If so, why? If not, why not and what alternatives do you propose. Do you agree that, under the adaptation to IAS 16.34, full revaluation will only be required where there are indicators of impairment under IAS 36, or where no appropriate indices are available?***

55. We agree with the proposed adaptation of IAS 16.
56. However, preparers should not be left under the impression that the true and fair principle is no longer applicable because it is, as per IAS 1. We also believe that a more frequent revaluation should be permitted should local factors render the carrying value to be materially different to the current value.

#### **Question 19**

***Do you agree that it is appropriate for accounts preparers (where necessary, in consultation with their valuers and using the RICS Red Book) to determine the most appropriate revaluation methodology for an asset given the methodologies being proposed by HM Treasury in this Exposure Draft? If so, why? If not, why not, and what alternatives do you propose?***

57. We don't think that changing the onus of determining the most appropriate revaluation methodology from the valuer to the accounts preparer will have much impact. The key is whether or not an observable market exists, which then drives much of the valuation technique.
58. Accounts preparers will ultimately have ownership of the numbers in their annual report yet should not be required to have in-depth knowledge of how to apply a particular valuation technique since that is likely to be outside their level of expertise.

#### **Question 20**

***Do you agree with HM Treasury's proposed changes to FReM paragraphs 10.1.10? It is HM Treasury's intention that a phased transition approach, supported by disclosure, will be permissible even where the impact is materially different to full transition on implementation. Do you agree that the revisions to FReM 10.1.10 achieve this intent?***

59. We agree with the removal of an alternative site when applying DRC as this adds unnecessary complexity and does not, in our view, result in values that are more useful to the users of the accounts.



**Question 21**

***Do you agree with the index examples HM Treasury have provided? If so, why? If not, why not and what alternatives do you propose? Are there any areas in respect of indexation where you think additional guidance might be required?***

60. We agree with the index examples HM Treasury has provided but also recommend one further index for land – UK Residential Development Land Index from Knight Frank. We are aware of the inappropriate application of BCIS all-in TPI for land valuations which needs to be addressed.

**Question 22**

***Do you agree with HM Treasury’s proposed guidance to add to chapter 10 of the FReM in respect of impairment reviews? If so, why? If not, why not and what alternatives do you propose.***

61. Yes, we agree with HM Treasury’s proposals.

**Question 23**

***Do you agree that the proposed FReM amendments reflect the HM Treasury position on non-investment asset valuation as set out in this Exposure Draft? If not, why not? Are there specific areas amendments that you feel require greater explanation or clarification?***

62. On the whole, the proposed updates to the FReM reflect HM Treasury’s position on non-investment asset valuations. But as noted in our response, we feel there is a gap for guidance on concessionary leases as we do not believe that peppercorn leases would meet the definition of a contract and should therefore not be in scope of the leasing standard.
63. If you would like to discuss any of the points raised in more detail, we would be more than happy to assist further.