National Audit Office

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Shikha Sharma
(by email)

Date 17 May 2023

Dear Shikha,

## RESPONSE TO CONSULTATION PAPER ON THE THEMATIC REVIEW OF NON-INVESTMENT ASSET VALUATION FOR FINANCIAL REPORTING PURPOSES

This letter provides responses from the National Audit Office (NAO) to the questions you have set out in your consultation paper on the Thematic Review of Non-Investment Asset Valuation for Financial Reporting Purposes.

Our responses are considered from the perspective of our responsibilities as auditor of central government bodies, including the Whole of Government Accounts, and also to the local government sector through our maintaining and publishing of the Code of Audit Practice for local government.

Noting the outcome of the thematic review, and in particular the current costs and delays in local government reporting, we consider that there is a clear case for change.

We support HM Treasury's preferred option (Option 3) as set out in the consultation. We have focussed our response on challenges in implementing this option and how they might be addressed.

We support HM Treasury's authority to set requirements in the accounting framework in line with the options described in the consultation, including: differentiating asset valuation approaches by asset class; use of historical (deemed) cost; and stipulation of periodic valuations in the accounting framework.

Through our consultation responses we have sought to highlight some of the implementation challenges and how these might be overcome. We have also set out our consideration of the alternative options which could be adopted following consultation. The main challenges we envisage arising on implementation of the different options focus on:

- the understandability of information where cost and current valuation measures are reported within a single asset note in the financial statements; and
- the subjectivity in the definition of specialised assets and the resultant challenge of auditing classification judgements.

We set out our detailed responses to the questions in the consultation document below.

## 1. Do you agree with the assessment HM Treasury has presented for Option 1? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**1.1.** We agree that the historical cost model is well understood as an accounting policy choice within IAS 16. Moving to a cost model would undoubtedly simplify and bring significant cost savings to both public sector bodies and their auditors.

**1.2.** However, as the consultation highlights, it is impractical for public sector bodies to recreate the historical cost information retrospectively and Option 1 proposes to recognise the value of the asset at the transition date at the asset's current value. The current value would equate to a historical (deemed) cost at the date of transition. We note there is a key challenge to Option 1, that historical (deemed) cost is not a recognised valuation approach that exists in International Financial Reporting Standards (IFRS). However, we consider that HMT have the authority to write this valuation basis into the FReM.

**1.3.** The Current Regime, in recognising all classes of assets at current value, provides a higher quality of financial reporting than a historical (deemed) cost approach. Hence, if required to answer the question, whether a move to a cost-based model would result in "the financial statements providing reliable and more relevant information"[1] as IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires, our answer would be no. We see no reasonable arguments can be posed that historical deemed cost would be more relevant information. However, HMT have the authority to set the accounting framework for government bodies through the Government Financial Reporting Manual. A change to the accounting framework by the standard setter is different to a change in accounting policy applied by an entity and we don't consider that IAS 8.14b would apply in those circumstances.

**1.4.** Moving to a historical cost, or deemed historical cost, approach may create significant challenges for measurement of networked assets over time given the complexity of maintaining cost records for assets with high levels of componentisation and / or long-term programmes of asset renewal. For networked assets held by central government we see significant benefits in the existing valuation basis of depreciated replacement cost.

**1.5.** We note that Option 2 would not address the existing issues in the valuation of local government infrastructure assets.

## 2. Do you agree with the assessment HM Treasury has presented for Option 2? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**2.1.** We agree with HM Treasury's assessment of the challenges presented for Option 2. We agree that the benefits in determining the highest and best use of assets under a fair value revaluation would result in additional cost such that the benefits would likely be outweighed.

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[1] IAS 8.14
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.

**2.2.** Moving to fair value measurements removes the need for Existing Use Valuation (EUV) basis. EUV was designed by RICS specifically for the public sector as an adaptation which recognises that the primary driver for public sector financial reporting is the service potential of the assets for ongoing delivery of existing services within a specific location, rather than a measurement of the opportunity cost of holding them in terms of the cash flows that could be generated through disposal. A move to fair value implies that the primary driver of public sector financial reporting is no longer the service potential of the assets.

## 3. Do you agree with the assessment HM Treasury has presented for Option 3? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**3.1.** We agree with HM Treasury's assessment of this option and support its implementation. We note the following challenges below which need to be considered as part of the implementation.

**3.2.** We believe that judgement over the categorisation of individual assets (highlighted at 3.42) is the primary challenge to implementing Option 3, especially between networked, specialised and non-specialised assets. In particular:

- The divergence between a valuation determined through historic (deemed) cost and fair value can be considerable, greater than the differences between DRC and EUV for specialised and non-specialised assets, making categorisation judgements more significant.
- The categories are open to judgement bias in public sector bodies and the classification between asset categories would likely become a significant judgement in our audits including the use of experts in some instances.
- Although the proposed definitions are based on existing RICS standards, there is currently subjectivity in the way the definition is interpreted by different valuers in assessing whether the asset is rarely sold in the market. Areas that will require careful consideration include:
    - how hybrid assets, those that have both specialised and non-specialised components, would be treated;
    - whether location can dictate if an asset is specialised in the absence of other factors (i.e., an office can be sold at a market rate but an office in X location might not have a market outside of government);
    - whether the market being considered is national or international; and
    - whether the market being considered is accessible.

**3.3.** We consider that detailed application guidance, as suggested in the consultation would be required to overcome these challenges, particularly around the classification of assets.

**3.4.** There is a risk that option 3 could result in similar assets presented alongside each other being measured on a cost or current value basis undermining the understandability of the accounts. Additional disclosure requirements or a re-organisation of assets notes may be required to help users understand the valuation methodologies being applied to different sections of the PPE note.

**3.5.** Under this option, any requirement to separately disclose current values for assets measured at cost in the financial statements would not result in the benefits the consultation is seeking to address as these disclosures are subject to the same audit scrutiny as values held on the balance sheet.

## 4. Do you think land and buildings should be considered as their own asset category under any of the options HM Treasury has presented? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**4.1.** Using a land and buildings asset category, rather than specialised and non-specialised definitions, is in line with asset classes used in financial reporting across government. When considering feedback from the consultation on the classification definitions feedback HMT could consider a separate category for land and buildings in response. Benefit may be gained in focussing the approach on the categories perceived to be more complex to value (typically land, buildings and networked assets), rather than change the Current Regime for the other categories (e.g., plant and machinery), which tend to be simpler to recognise and measure including due to shorter lives.

**4.2.** We note that an option to revalue land and buildings would, in following RICS guidance, lead valuers into judging whether assets were specialised or non-specialised regardless.

## 5. Do you agree with the assessment HM Treasury has presented for Option 4a? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**5.1.** We agree with HM Treasury's assessment of Option 4a (a historical deemed cost approach which is reset periodically to current valuation). Specifically, we agree that adopting two different bases for assets (historical cost and current value) creates tension with the Conceptual Framework and IAS 16, which prescribes the use of one or another method, not both.

**5.3.** A challenge not cited in the consultation, is the extent to which user understandability would be diminished by a framework which adopts both the cost and valuation bases, especially when the dual approach of Option 4a is a departure from IAS 16.

**5.4.** We are unclear as to how Option 4a would interact with IAS 36, as there would still be a requirement for an impairment review under the historical (deemed) cost approach.

**5.5.** We consider option 4b to be better than option 4a.

## 6. Do you agree that Option 4a can be applied in conjunction with Option 3? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**6.1.** We consider it possible to include Option 4a and 3 in conjunction. As we favour Option 4b above Option 4a, we discuss this point below.

## 7. Do you think there is a risk that Option 4a would not be considered true and fair, and so a pronouncement from the regulator would be necessary to address any ambiguity? If so, why? If not, why not and what alternatives do you propose?

**Disagree**

**7.1.** The FReM already contains accounting requirements which depart from IFRS, such as the approach to accounting boundaries and consolidation, but which remain consistent with providing a true and fair view. We consider HMT has the authority to set the requirements of the FReM as the financial reporting framework. From a central government audit perspective, we consider a pronouncement from a regulator is not necessary.

## 8. Do you agree with the assessment HM Treasury has presented for Option 4b? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**8.1.** We agree with the assessment presented for Option 4b. We consider Option 4b to be a reasonable alternative to Option 3. However, we consider Option 3 better meets the case for change and will go further to setting a proportionate reporting and auditing regime for the public sector.

**8.2.** HM Treasury's proposed mitigation in paragraph 3.50 to implementing the changes across phased tranches appears to be a reasonable solution to the problem of concurrent quinquennial valuations.

**8.3.** Overall, we believe this option is 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 un-indexed or indexed proxy between revaluations. We would favour an indexed proxy.

## 9. Do you agree that Option 4b can be applied in conjunction with Option 3? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**9.1.** We consider it is possible that Option 4b could be applied in conjunction with Option 3. Assuming the asset classes proposed in option 3 are maintained, the application to specialised assets would have most benefit from being brought up to current value. If appropriate for specialised assets, there might be an argument for moving non-specialised assets into a regime that only revalues every five years. Separately discussed later we have reservations on the proposal to change the valuation basis from EUV to FV. But either option could have a mandated revaluation period as dictated by Option 4b.

## 10. Do you think there is a risk that Option 4b would not be considered true and fair, and so a pronouncement from the regulator would be necessary to address any ambiguity? If so, why? If not, why not and what alternatives do you propose?

**Disagree**

**10.1.** In our view, Option 4b combined with indexation in intervening years would present a true and fair view. Furthermore, we note that there is precedent for HM Treasury making adaptations to IFRS through the FReM consistent with a true and fair view such as adaptations to the accounting boundary.

## 11. Do you agree with the assessment HM Treasury has presented for other options? If so, why? If not, why not and what alternatives do you propose?

**Observations:**

**11.1.** HM Treasury has dismissed permitting a reduced frequency of valuations under the Current Regime; however, we believe that this would be within your remit of authority to permit. If this option were considered, any minimum period would need to be set out in the FReM.

**11.2.** We note that the consultation doesn't directly address the question of the valuation of local authority infrastructure assets.  Noting that previous attempts to move to a Depreciated Replacement Cost valuation failed, we consider a simplification to the current DRC methodology could be productively explored if DRC is applied to local infrastructure assets. Under this simplification HM Treasury or another central body supported by professional valuers could set 'beacons' for key data inputs into DRC valuations e.g., for building type, location and square footage which would be periodically published by HM Treasury (similarly to PES discount rates) and updated between years by indexation. These could then be applied in valuations across government bodies. This option would not seek to establish the most accurate valuation for individual publicly owned assets but would provide the users of the accounts enough information to materially establish the service potential of those assets as well as providing trend information and comparison between entities. Such an approach would reduce preparer and audit resource required, both time and cost. It would also ensure consistent assumptions are applied across government.

## 12. Do you agree, in general, with HM Treasury's proposed changes, to be reflected in FReM adaptations and interpretations to International Accounting Standard 16 Property Plant and Equipment (IAS 16) and adaptations to International Accounting Standard 38 Intangibles (IAS 38), in respect of the measurement of assets? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**12.1.** We support the proposed changes in general. In considering the proposed use of historic (deemed) cost with specific reference to non-specialised assets we have set out below some of the implementation challenges that need to be addressed in adopting this approach.

*Differing measurement criteria for categories of assets will magnify challenges in classifying them*

**12.2.**There is already an existing differential valuation regime based on asset class with specialised assets being valued using depreciated replacement cost and non-specialised assets being valued applying market value in existing use. Ultimately, the different valuation options employed within the Current Regime all seek to determine an asset's current value in existing use. However, the change in the differential approach proposed in Option 3 would magnify the difference in outcomes between networked, specialised and non-specialised assets. The materiality of the classification would become more significant. Consequently, there is a magnification of the challenges in classifying between specialised and non-specialised assets including where assets are:

• hybrid (for example embassies, which include secure perimeters as a specialised element of a non-specialised building)

• cannot be sold as a function of operating in government; or

• could be judged to be specialised based on their location (for example offices that house multiple public sector bodies in locations where only the public sector is a significant employer).

**12.3.** There would be increased incentive for public sector bodies to bias a decision towards specialised when judging asset classification. Our audit teams have highlighted a number of areas where this judgement would be complex and could lead to similar assets having different valuation bases with subjective guidance this area would risk becoming an area of high audit focus. This type of bias will not be present outside of government and therefore there would be minimal external guidance to draw from. A similar example is the classification of an accrual or provision, for budgeting purposes in central government the classification here is significant, but external to government these are both estimated liabilities with minimal need to differentiate and therefore guidance on the classification between the two is limited.

**12.4.** This option may introduce new challenges in disaggregating non-property assets (e.g., plant and equipment, usually with shorter useful economic lives) between specialised and non-specialised categories. Under the Current Regime, these assets are commonly revalued according to appropriate indices. There may be benefit to HMT from separating non-property assets from land and buildings as classes of assets in designing a new approach, as discussed under question 4.

**12.5.** We support further guidance around the definition of networked, specialised and non-specialised assets.

*Historical (deemed) cost*

**12.6.** Transitioning to a cost model from the revaluation model for certain classes of assets may provide users with less relevant information. However, we consider HMT have authority to implement this change and that the overall case for change is made. We have considered the differences between historic (deemed) cost and historic cost. We note that over time these values will converge. Having given it reasonable consideration we judge that historic (deemed) cost is not less relevant than historic cost as a valuation basis and historic cost is permissible under IAS 16. Therefore, whilst historical deemed cost is not a measurement basis in IAS 16, we consider that it could present a true and fair view if mandated through the FReM.

*Presentation of assets in the financial statements will need further consideration*

**12.7.** Asset notes could be prepared with a mixed currency of assets held at historic (deemed) cost and valuation, including within the same asset class. The associated transparency to users through disclosure will need careful consideration.

*Disclosure requirements*

**12.8.** The consultation is silent on any additional disclosure requirements associated with its preferred Option 3. Any requirement to disclose values of assets under a current value model would be subject to the same level of audit scrutiny as ‘on balance-sheet’ valuations and, therefore, any benefits of a simplified approach would be eroded.

*Non-specialised assets*

**12.9.** We have set out our view on the proposed valuation approach to non-specialised assets under question 18. We do not consider there is a clear case for change.

*Alternatives proposed*

**12.10.** A more standardised beacon approach to Depreciated Replacement Cost for comparable assets as described in 11.2 might be considered.

## 13. Do you agree with the proposed measurement basis for networked assets? If so, why? If

## not, why not and what alternatives do you propose?

**Agree**

**13.1.** We support the ongoing use of depreciated replacement cost for networked assets for the reasons set out in the consultation.

**13.2.** If Option 3 is adopted more guidance will be required to overcome ambiguities in the consultation's definition of networked assets (paragraph 4.18). The current definition is not specific enough to determine the classification of some infrastructure assets which could reasonably meet the definition of specialised or networked assets.

**13.3.** Clarity over classification definitions might be improved by:

- using a flowchart that provides preparers with a hierarchy of classification.
- having a starting presumption of asset class that needs to be rebutted using set criteria; as well as
- changes to the proposed definitions.

## 14. Do you agree with the HM Treasury definition of specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

**Disagree**

**14.1.** Though we acknowledge the proposed definition for specialised assets aligns to RICS guidance[2], there is currently ambiguity in how the definition is interpreted by different valuers such that, in some cases, it results in different conclusions about whether an asset is specialised or non-specialised. We believe HMT needs to go further in its proposed definition of specialised assets to overcome these ambiguities where the resultant measurement basis differs between historic (deemed) cost or fair value. We have particular concerns where assets contain certain characteristics such as hybrid assets or those that are specialised purely as a result of their location, as we set out under question 12.

**14.2.** The ambiguities in the classification of assets between networked, specialised and non-specialised may be open to bias towards the simpler approach. We think it will be common for networked assets to also meet the definition of specialised asset.

**14.3.** Under the Current Regime, any differences in valuers' conclusions between specialised and non-specialised assets (applying the Depreciated Replacement Cost approach or Existing Use Valuation, respectively) have limited impact as both currently seek to achieve a reasonable estimate of a property's current value in use. Concurrent to HM Treasury's consultation on asset valuations, RICS has held a consultation on the Existing Use Value that sought to clarify some of these existing ambiguities and provide updated guidance to valuers in the Summer of 2023. We anticipate that this will mitigate some of the existing issues with classifying assets under the Current Regime, but these will recur under the proposed definition without additional specific guidance.

**14.4.** Comments captured in para 13.3 are relevant to improving the specialised asset definition in conjunction with the others.

## 15. Do you agree with the proposed measurement basis for specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

[2] [Depreciated replacement cost method of valuation for financial reporting, 1st edition (rics.org)]

**Agree**

**15.1.** We support the implementation of Option 3 including the measurement of specialised assets at historic (deemed) cost. We note that current valuation is a less useful measure for assets which are not traded and especially those that do not have alternative use.

**15.2.** Our reflections on the principles of historic (deemed) cost have been captured in para 1.1-1.4 and 12.7.

## 16. Do you agree it could be suitable for the starting point for valuation of specialised assets to be initial historical cost, but if this information is not available, then measure at historical deemed cost? If so, why? If not, why not?

**Disagree**

**16.1.** There may be an expectation gap between HM Treasury, public sector bodies and their auditors in the level of effort expected to be given to establishing historic cost on transition, before applying historical (deemed) cost. Without further clarification, we believe there is little incentive on public sector bodies to invest in establishing historic cost, although this would be a truer application of the 'historic cost' approach as set out in IAS 16.

**16.2.** Leading on from this, it is, therefore, unclear the level of challenge that will be expected from auditors to determine historic cost.

**16.3.** We have noted in our considerations of historic (deemed) cost in question 1 that historic (deemed) cost and historic cost would eventually converge, and one is not a significant improvement on the other, therefore the effort to obtain genuine historic cost documentation may be significant for negligible improvement.

## 17. Do you agree with the HM Treasury definition of non-specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

**Disagree**

**17.1.** As described in question 14, the definitions of specialised and non-specialised assets are not sufficiently detailed enough to be able to establish the correct classification for many public sector assets, for example, those which have both specialised and non-specialised features.

**17.2.** The specialised and non-specialised asset definitions are not linked to each other i.e., one is not 'n' and the other '1-n'. There is no hierarchy between the two.

**17.3.** The definition uses an example of an office building, an asset that we have already identified could be argued as specialised if it had specific security requirements or was in a location specifically for achieving public sector outcomes.

**17.4.** See our response in para 13.3.

## 18. Do you agree with the proposed measurement basis for non-specialised assets (PPE)? If so, why? If not, why not and what alternatives do you propose?

**Disagree**

**18.1.** The current valuation approach for non-specialised assets is market value in existing use (or Existing Use Value as described by RICS), which recognises that “the primary driver of public sector financial reporting is the service potential (operational capacity) of these assets for ongoing delivery of existing service within a specific location, rather than a measurement of the opportunity cost of holding them in terms of the cash flows that could be generated through disposal”[3]. Changing to fair value valuations might infer that the assets are non-essential for public service delivery. We believe that the purpose of the assets held by public sector bodies warrants the existence of the EUV approach.

**18.2.** One of the differences between valuing under fair value basis as compared to EUV will be the requirement on the valuer to perform additional analysis to support that no other uses or potential uses of the asset would result in best use value. This could create additional burden on public sector bodies, their auditors and their experts who will need to assess the differences in valuation arising from exploring the best use. This would result in additional time and cost of valuations over and above the Current Regime. Based on these additional considerations, we are not persuaded that the case for change is supported. To some extent the exercise to define the best use would be fruitless if the best use would not be accessible as the assets are not surplus to government. We continue to support surplus assets being valued using fair value.

**18.3.** The existing valuation method of Existing Use Value would be the most appropriate alternative as it is designed to take account of the primary driver of public sector financial reporting being the service potential of these assets. We note that one of the arguments for change in the consultation document was the fact that EUV is a valuation basis on used for the public sector which creates additional requirements for valuers in designing and maintaining the approach.  Given that the proposal is to retain EUV for Social Housing we consider it would be appropriate to retain it for non-specialised assets more generally.

## 19. Do you agree with the proposed measurement basis for operational and non-operational heritage assets? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**19.1.** We note that no changes are proposed to the measurement basis for operational and non-operational heritage assets.

## 20. Do you agree with the proposed measurement basis for social housing assets? If so, why? If not, why not and what alternatives do you propose?

**20.1.** We do not audit social housing assets and therefore have limited insights in this area. We have no concerns with the proposal to continue to apply EUV.

## 21. Do you agree with the proposed measurement basis for surplus assets? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**21.1.** We agree that measurement at fair value, as per the Current Regime, is an appropriate measurement basis for surplus assets. This is on the basis that when the asset becomes surplus, it is reasonable to consider its highest and best use in deriving a valuation.

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[3] RICS Draft Professional Standard: Existing use value (EUV) valuations in UK public sector financial statements, 1st edition - RICS iConsult

**21.2.** We note that under the Current Regime, there is typically little change when an asset becomes surplus, except to ensure that alternatives uses of the asset have been considered in the valuation. Under a historical (deemed) cost model, the change will become a much more significant revaluation exercise.

## 22. Do you agree with the proposed measurement basis for intangible assets? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**22.1.** We agree that moving to a historical (deemed) cost model would be appropriate for intangible assets on the basis that: they commonly have relatively short useful economic lives and therefore holding at current value is less relevant to the users of the account; and establishing current value under a revaluation model is often difficult as there is a lack of observable market for these types of assets. In our experience, intangible assets are frequently valued by indexation.

## 23. Do you think the proposed changes of the preferred new option will improve the financial reporting for users of the account? If so, why? If not, why not and what alternatives do you propose?

**Disagree**

**23.1.** The move away from current value as a consistent basis of reporting provides less current and relevant information to users and will not improve financial reporting for users of the accounts. However, we consider that it is appropriate to consider options that will improve the timeliness of reporting and reduce the cost of the regime where the impact on the quality of financial reporting is limited.

**23.2.** Where asset notes contain a mixture of asset classes as described under Option 3, the associated transparency to users even with supporting disclosure may be reduced. For example, it would be possible for 'property' disclosed in the notes to contain assets measured at historic cost, historical (deemed) cost and fair value.

## 24. Overall, do you agree with the sub-classes of assets HM Treasury has identified as in scope of IAS 16 for the purposes of the differential regime proposed? If so, why? If not, why not and what alternatives do you propose?

**Agree**

**24.1.** We agree with the proposed sub-classes of assets HMT has identified for the differential regime but would recommend that these are considered in conjunction with the current presentation of PPE and IA notes reported. There is a risk that clarity of user's understanding with the reporting of assets in the accounts may be reduced, as discussed at 23.3.

**24.2.** An alternative would be to base the classifications of assets broadly on the presentation of assets typically disclosed in public sector bodies' financial statements, e.g., land, buildings, plant, infrastructure assets etc.

## 25. Are there any areas of ambiguity in the proposal that you think will require further guidance? If so, what areas would require further guidance?

**Agree**

**25.1.** We are broadly supportive of the areas of guidance which HM Treasury has already set out in Chapter 5. In addition, we would propose additional areas of guidance to mitigate for some of the challenges we foresee with the proposed new approach:

- Detailed definitions and processes for determining the classification of the asset classes, whether this remains networked, specialised and non-specialised assets or new classes are implemented. We have set out suggestions at para 13.3.

  Cross-referring to the definitions provided by RICS of the different valuation methodologies may support these definitions (including applying the new guidance on EUV once implemented, following the recent consultation).

- Guidance on how to determine the treatment for assets which contain features of different asset classes, for example both specialised and non-specialised features. An approach might include splitting assets into their component parts for valuation purposes or it might involve choosing the class which reflects the majority of the asset or there is a presumed asset class type that would not be sufficiently rebutted in a hybrid scenario.

- If option 3 is adopted guidance on disclosures will be required. This might include whether the PPE note as currently prepared should be made of sub notes capturing the different valuation approaches applied. There should also be guidance issued on how to explain the cross-currency of different valuations applied.

- Preparers of the account will need guidance for the ongoing treatment of historic revaluation reserves on transition to ensure consistency between public bodies.

- How assets that change their use and, therefore their asset class, should be considered within this framework. There are two points we foresee may need to be anticipated through additional guidance:

  a) In circumstances where the public body or their auditor may reconsider the appropriateness of past judgements about asset classes after transition. Should there be a ‘bar’ to be reached before judgements about classification made on transition can be changed? Or are such judgements irrevocable?
  b) In circumstances where there has been a genuine change or partial change in use which results in the classification of the asset moving from one class to another following a capital project or restructuring.

- We would welcome further guidance on impairments and how these are considered within the new regime, although we note that the need to assess assets for impairment already exists within the current valuation regime.

## 26. 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 accelerated to financial year 2024-25? If so, why?

**Agree**

**26.1.** We are in agreement with a 2025-26 implementation, though this is dependent on the nature of the feedback actioned following the consultation period. An accelerated effective date runs a greater risk in not having enough time to prepare. It may also need time for the changes proposed for the FReM to be adopted into financial reporting regimes which apply to local government and NHS bodies.

## 27. Do you agree with the proposed timeline for implementation? If so, why? If not, why not

**and what alternatives do you propose?**

**Agree**

**27.1.** The proposed timetable for implementation in time to implement in 2025-26 is reasonable.

## 28. Do you agree with the transition approach for the proposed amendments to the FReM? If so, why? If not, why not and what alternatives do you propose?

**Disagree**

**28.1.** The transition approach is not clearly described within the consultation, as it is noted this will be subject to further preparation of guidance and consultation in Autumn 2023. We would welcome the opportunity to provide feedback on the transition guidance when it is available.

**28.2.** It would be beneficial for different standard setters across local government and the NHS were aligned to ensure guidance allows for a smooth transition and consistency between sectors.

**28.3.** We would recommend transition guidance would capture:

- Whether the new approach will be a change in accounting standard or accounting policy and, therefore, what kinds of restatements we would expect to see in financial statements as a result? We consider that it would be a change in accounting standard.
- How public sector bodies which contain a qualification on their asset valuation at the point of transition should be treated as historical (deemed) cost? Similarly, if a prior period error is identified which impacts on the historical (deemed) cost?
- Whether there is enough time for public sector bodies to consider alternative uses for non-specialised assets moving from EUV to fair value valuation?
- What the disclosures for new accounting policies not yet adopted would look like? and
- Are asset classifications already determined to be grandfathered or re-assessed?

**28.4.** The information required to prepare for transition will be dependent on the final proposal to be implemented.

## 29. Are there any areas of further guidance required for transition? If so, what areas would require further guidance?

**Agree**

**29.1.** See answer to question 28.

## 30. Are there any other areas not covered by the questions which you would like to comment on? Please explain any comments, including providing alternatives HM Treasury should consider.

**Agree**

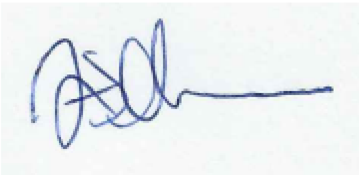
**30.1.** We would recommend that there is consideration for the potential differences in approach between owned specialised assets and leased specialised assets under IFRS 16, the latter recognised at fair value.

**30.2.** Whilst specific to the Ministry of Defence we note that there are application questions for the treatment of ‘capital spares’ accounted for under IAS 16.

**30.3.** Public sector bodies who follow the charities reporting framework (Charities SORP) are one of the biggest critics of the valuation regime in terms of the cost/ benefit of producing annual valuations of their assets. As they do not report under the FReM, the proposed changes will not benefit this sector, but will result in differences between the measurement of similar government-owned assets whose bodies report under differing frameworks.

We look forward to the outcome of the consultation in due course.

Yours sincerely



**James Osborne**
**Director, Financial Audit Practice and Quality**