HFMA Response
May 2023

Response to HM Treasury's thematic review of non-investment asset valuation for financial reporting purposes

Introduction

In 2022, HM Treasury undertook a thematic review of non-investment asset valuations. The review found that there was a case for changing the way that property, plant and equipment, and intangible assets are valued.

In March 2023, HM Treasury published their consultation paper on changes that will affect the adaptations and interpretations for the public sector of *International accounting standard* (IAS) 16 *Property, plant and equipment* and IAS 38 *Intangibles* (IAS 38). These adaptations and interpretations will be set out in the *Financial reporting manual 2025/26* (FReM) and will also be reflected in the DHSC *Group accounting manual 2025/26* (GAM).

The consultation sets out four options but proposes that option three is adopted:

- option 1 is to transition to the historical cost model
- option 2 is to continue with the revaluation model but hold all assets at fair value
- option 3 is to refine the valuation method based on the asset category (see table below)
- option 4 is to be more prescriptive about the frequency of revaluation:
    - either a periodic reset of deemed cost to current valuation
    - or to continue on the current basis valuation basis, or the basis proposed in option three, but prescribe that the valuation should take place every five years.

The proposed changes in option 3 are summarised as follows:

Asset category	Current measurement	Proposed measurement
Networked assets, such as roads and water systems	Depreciated replacement cost. Local authorities currently depart from the FReM and measure networked assets at historical cost	Depreciated replacement cost
Specialised property, plant and equipment	Depreciated replacement cost	Historical (deemed) cost

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Asset category	Current measurement	Proposed measurement
Non-specialised property, plant and equipment	Market value in existing use	Fair value
Heritage assets	Current value like other IAS 16 assets. Non-operational heritage assets are reported at historical cost where it is not practical to value	No change proposed
Social housing costs	Existing use value	No change proposed
Surplus assets	Fair value	No change proposed
Intangible assets	Market value in existing use. Low value or assets with short asset lives are valued at historical cost	Historical (deemed) cost

Consultation response

Question 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?

We agree with the assessment presented for option one. As noted in paragraph 3.35, the disparity between historical cost and current value may well be a significant challenge in applying this option.

Using the current value at the date of transition as historical (deemed) cost means that, in the NHS, a hospital built before 1948, one built shortly after that and another built more recently could have the same historical (deemed) cost depending on the valuer's approach and the judgements and estimates made by the NHS body's management.

It is not clear why the fact that similar assets that have been acquired at different times would be reported at different values is considered to be an issue. Depreciation over the life of the asset means that the net book value of assets does precisely that.

It would be helpful to understand how this option differs in practice from option three as they both use current value as a proxy for historical cost.

Question 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?

We agree with HM Treasury's view that the additional costs of applying this option may well outweigh the benefits derived due to the limited market comparators available for public sector buildings such as hospitals. One of the concerns about the current approach to valuation is the volume of judgements and estimates that need to be made – this approach would require different judgements and estimates but would not address the problems with the current arrangements. The current issues with audit capacity and the impact on timeliness of local audit would not be resolved by the implementation of this option.

Paragraph 3.39 says that this option may result in increased comparability with private sector entities – it is not clear whether this is considered an advantage of this option. Public sector and private sector entities both hold assets to carry on their business and provide services but there are differences between the sectors. For example, NHS bodies have to provide services in specific localities and serve the whole population whereas private sector organisations can decide to move their business if that would increase profits. Increased comparability would not reflect these differences.

Question 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?

We agree with the assessment presented for option three.

We note the potential judgement around the categorisation of assets may increase the level of audit challenge and therefore costs and delays.

Having said that, in the NHS, assets are already categorised and different measurement techniques applied depending on the category. This is summarised in GAM 2022/23 in paragraphs 4.180 and 4.181. The application guidance would therefore need to be clear whether the existing arrangements would be carried forward into the new arrangements or whether a new assessment and categorisation would be required.

As we noted in our response to question one, this option means that there is going to be increasing disparity between historical cost and current cost.

We do not support the proposal to continue to report current values in the financial statements or in the unaudited section of the annual report. If this information is considered necessary for the reader of the accounts, then it should continue to be produced and the current arrangements do not need to be changed. If it is not necessary, then it is additional work for the preparers of the accounts and additional detail that could obscure the reader's understanding of the accounts.

Question 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?

Currently, land and buildings are a separate asset category so there does not seem to be a reason to change this. However, it is not clear whether this would be in addition to the new categories of specialised and non-specialised assets – in the NHS, some land and buildings are specialised and others are not. Paragraph 4.10 says that the asset classes in option four will continue to use asset categories currently set out in the FReM, for NHS bodies these are listed in paragraph 5.133 of the GAM.

Further clarification of the differences between classes of asset and asset categories would be useful. We note that IAS 16 requires the entire class of property, plant and equipment to be revalued on the same basis and does not use the term category.

Question 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?

We agree with this assessment and note the tension with the conceptual framework. This option does not resolve all the issues with the current arrangements.

Question 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?

We agree that the periodic reset to current valuation (option 4a) can be applied in conjunction with having separate measurement bases for each class of assets (option 3). We note that under the current regime, IT equipment, transport, furniture and fittings and plant machinery are valued at depreciated historic cost and this is not considered to be materially different from the current value.

Question 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?

This question is one for the audit firms. NHS bodies are directed to prepare their accounts in accordance with the DHSC's *Group accounting manual* (GAM) so if that mandates this option then their accounts will be true and fair in accordance with the directions and the GAM. A pronouncement in the form of guidance in the FReM and the GAM should therefore reduce the risk of qualifications in audit reports.

Our bigger concern with this option is that it will still require the input of professional valuers or other experts to provide appropriate indices. The issues identified in the case for change, namely that measures are needed to improve the timeliness of local audit and support audit capacity, will not have been addressed as entities will need to ensure that the revaluation or indexation every five years results in an appropriate current valuation.

Question 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?

We note that quinquennial valuations would still attract the level of challenge and therefore expense associated with the current arrangements. However, if there was prescription around the timing of valuation then this option would reduce some of the costs, in both cost and time, that are currently incurred. It may avoid some of the issues that we have identified with option three.

It is worth noting that Welsh NHS bodies undertake a valuation every five years with indexation in the intervening years. As far as we are aware, there has been no recent change in the adaptations to the accounting standards - the move to more frequent valuations in England seems to have resulted from changes to the audit regime in relation to the requirement to ensure that 'carrying amounts are not materially different from those that would be determined at the end of the reporting period'. Additional interpretations may resolve this issue.

Question 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?

We agree, for the same reasons set out in response to question 6.

Question 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?

We have the same concerns as set out in our response to question 7.

Question 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?

We agree with the assessments presented for other options.

Question 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?

We agree, given that IAS 16, paragraph 36 states 'If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued' and IAS 38, paragraph 72 states 'If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets'. FReM adaptations and interpretations would be appropriate and welcome in order to reduce complexity and increase efficiency of non-current asset valuation and reporting.

It is not clear from the paper how impairments would be assessed when the valuation is, in effect, fixed. While impairments resulting from damage to the asset could be assessed, it is not clear how changes in market value would be dealt with going forward. Our concern is that impairment reviews, and any consequent impairment, would be much less predictable than the current arrangements for valuations and could therefore be more difficult to manage.

Question 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?

NHS bodies do not hold networked assets, so we do not have a view on whether this measurement basis is appropriate or not.

Question 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?

We agree with the definition. In a healthcare setting, hospitals have specialised features and adaptations and have to be in a particular location with no recent market transactions of similar assets. However, this is an area where additional application guidance would be welcomed as there is an element of judgement in determining whether some assets are specialised in nature. For example, community healthcare settings do not usually include so many specialised features and could be used for other purposes with some adaptation. However, there are unlikely to be market transactions that could be used to reach a fair value valuation and they usually need to be in that particular location.

There will need to be some thought given to those assets currently classified as non-specialised but where there is no useful market information available. For example, some offices on NHS sites may be treated as non-specialised at the moment, but the reality is that there would be no market for them as no-one else will want to have offices in the middle of a hospital site. This is the sort of detail that would need to be considered in further guidance. It would be helpful to discuss with preparers of accounts whether this situation would be a problem for them – the information in the accounts does not make it clear at the moment.

As there is no proposal to change the definition of specialised assets, it would be helpful to have confirmation that the current assessment of assets as specialised or not will not need to be reassessed under the new proposals.

Question 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?

We agree that determining the replacement cost of the service potential of an asset is a subjective matter. Our briefing *Property, plant and equipment - accounting and valuation issues*[1] was written to try to help NHS finance teams when they engage with valuers. As set out in paragraph 4.22 of the consultation document the level of judgment required in determining depreciated replacement cost weakens its reliability.

In the NHS, experience is that when assets are brought into use from assets under construction, there is a significant impairment when they are valued for the first time. We would therefore agree that depreciated replacement cost valuation has limited connection to the actual cost of replacing the asset.

Question 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?

It is unlikely that the initial historical cost for most NHS assets will be available – unless they were built or purchased in the last five, possibly ten, years. It would be helpful if the application guidance provided an indication of what the expectations are in how far back entities should go to try to determine the initial historical cost of assets.

Where that initial cost is not available, the consultation document is not clear on what the historical deemed cost will actually be. We assume that it will be the value that specialised assets are held at on 31 March 2025, which will be on a depreciated replacement cost basis. If not, then valuers will need to be engaged to determine the historical (deemed) cost and appropriate guidance will need to be provided to determine that valuation.

If the depreciated replacement cost valuation is going to be used, then the judgements in that valuation will effectively be fixed in time and in the accounts. The change in value may mean that, in the year of transition, NHS bodies and their auditors will want to undertake more work to ensure that they are satisfied that the valuation is an appropriate historical (deemed) cost.

Question 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?

We agree with the definition, effectively non-specialised assets that are not specialised in nature and not held for sale or investment. However, the move to fair value could mean that valuations are still required each year (albeit with fewer assumptions) which may not address the reason for the proposed changes. As we said, in our response to question 14, detailed application guidance would be helpful. As long as there is detailed guidance on the other classes then it should be clear that any assets that do not meet the definition of the other classes will be non-specialised.

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[1] HFMA, *Property, plant and equipment - accounting and valuation issues*, updated February 2022

Question 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?

We agree, based on likelihood of a ready market for such assets to secure a fair value. The risk of challenge to the value may be mitigated by the presumption, in IFRS 13, para 29, that an entity's current use is an asset's highest and best value.

Question 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?

NHS bodies are not expected to hold heritage assets (paragraph 4.208 of the GAM), so we do not have a view on the practicality of the proposed measurement basis.

As we said in our response to question 14, we assume that as the definition of heritage assets is not changing, there will be no requirement to reassess this classification on transition.

Question 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?

As with questions 13 and 19, NHS bodies do not hold social housing assets, so we do not have a view on this question.

Question 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?

We agree as fair value represents the highest and best use, which may be to sell. Unless the surplus asset is specialist in nature, market values should be readily available.

Question 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?

We agree with the proposal as market values have always been difficult to determine. However, the application guidance will need be clear about what valuation should be used where historical cost is not available or where assets have been previously been valued at market value in existing use.

Paragraph 4.47b of the consultation document says that historical (deemed) cost is well understood and easy to verify – we are not sure that this is the case because public sector entities have been valuing assets for so long now. A clear definition is needed and guidance on what action needs to be taken when historical cost information is not available.

In relation to intangible assets, the more difficult question at the moment is whether software meets the definition of an intangible asset or is software as a service. This is particularly the case where software needs to be adapted to meet the needs of the organisation that is purchasing it.

Question 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?

We think changing to the new option will reduce the levels of judgment required to determine asset valuations, this will therefore also reduce auditor challenges and therefore time and cost for audited accounts submission.

We are not sure whether it will have any impact on the users of the accounts.

Question 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?

We agree with the sub-classes, as noted in response to questions 14 and 19, we assume that there will not be a requirement to reassess this classification on transition. There will be a need for clear application guidance for preparers of the financial statements to ensure the correct classification.

Question 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?

Guidance on the categorisation of individual assets will be necessary (as suggested in paragraph 3.43) to reduce judgement and avoid challenges to the treatment of individual assets in the accounts of reporting bodies.

As we have referred to earlier, there needs to be guidance relating to non-specialised assets that are on the same site as specialised as this means that there is unlikely to be a market valuation. There may be a case for classifying a whole site as specialised rather than individual buildings.

As stated in our response to questions 16 and 22, clear guidance will be required on what historical (deemed) cost valuation means and what the transition arrangements will be, particularly, where historical cost information is not available.

Question 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?

1 April 2025 is the earliest that the standard could be adopted in the NHS.

The effective date of 1 April 2025 means that public sector bodies will be adopting this change and IFRS 17 *insurance contracts* at the same time. Assuming that the HM Treasury timeline is followed without delay, there should be enough time to understand the proposals and engage with non-finance colleagues who maintain data on fixed assets, auditors and valuers to ensure compliance with the proposals.

Question 27: Do you agree with the proposed timeline for implementation? If so, why? If not, why not and what alternatives do you propose?

We agree with the proposed timeline for implementation.

Question 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?

Subject to our earlier comments, we agree with the transition approach.

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

This consultation covers the valuation methodology to be adopted. There are other areas in relation to accounting for non-current assets that may change as a result, for example:

- how should subsequent expenditure be accounted for?
- will the change in valuation have any effect on estimated useful asset lives?
- what information needs to be maintained when building or buying new assets?
- will holding assts at historical cost have any effect on expenditure capitalised during a new build?

The wider implications of changing the valuation methodology on accounting for non-current assets and managing capital expenditure against departmental expenditure limits should be considered.

Question 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.

It will be important to maintain the overall objective of the proposals when developing these amendments, which is to reduce time and expenses incurred with valuers and auditors while providing useful information to users of the accounts. As we said in our earlier answers, guidance on classification and categorisation will be key to removing any remaining ambiguity and potential challenges to values.

We note that there is very little detail on what these proposals mean for right of use assets under IFRS 16 *leases.* As IFRS 16 has only been adopted in 2022/23, careful consideration needs to be taken to changing the approach. However, the approach taken to IFRS 16 has been to ensure consistency with IAS 16 as much as possible and we think that this approach should be continued.

As indicated in paragraph 6.2 of the proposal, in the NHS, there will need to be an assessment of what the changes in valuation mean for public dividend capital dividend calculations as well as for depreciation charges and impairments. Current valuations and depreciation are used to determine NHS bodies' capital allocations[2] so the impact of these changes on that process will also need to be considered.

There may be a need for some transitional funding or other adjustments for organisations that experience unfunded increased depreciation charges resulting from changes to valuation methods.

[2] NHS England, *Capital guidance 2022 to 2025*, April 2022 and NHS England, *Capital guidance update 2023/24*, January 2023

About the HFMA

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff in healthcare. For over 70 years, it has provided independent and objective advice to its members and the wider healthcare community. It is a charitable organisation that promotes best practice and innovation in financial management and governance across the UK health economy through its local and national networks.

The association also analyses and responds to national policy and aims to exert influence in shaping the wider healthcare agenda. It has particular interest in promoting the highest professional standards in financial management and governance and is keen to work with other organisations to promote approaches that really are ‘fit for purpose’ and effective.

The HFMA offers a range of qualifications in healthcare business and finance at undergraduate and postgraduate level and can provide a route to an MBA in healthcare finance. The qualifications are delivered through HFMA’s Academy which was launched in 2017 and has already established strong learner and alumni networks.

HFMA
HFMA House, 4 Broad Plain, Bristol, BS2 0JP
T 0117 929 4789
E info@hfma.org.uk

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HFMA is also a limited company registered in England and Wales, no 5787972. Registered office: 110 Rochester Row, Victoria, London SW1P 1JP

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