Consultation Response

# Thematic Review of Non-investment Asset Valuation for Financial Reporting Purposes - Consultation Paper

Response by the Royal Institution of Chartered Surveyors (RICS).

# Introduction

## Summary

**The Royal Institution of Chartered Surveyors (RICS) is pleased to respond to HM Treasury's consultation paper - Thematic Review of Non-investment Asset Valuation for Financial Reporting Purposes. We do so from our perspective as the principal professional body for property valuation in the United Kingdom, operating under Royal Charter and working for the public advantage. RICS maintains independently governed regulatory arrangements for all registered firms and individual professionals who work to RICS standards both in the UK and in many countries around the world. As such we are uniquely placed to comment in respect of the proposals relating to the valuation of non-investment property valuations being undertaken in the UK public sector. In light of our systemically important remit in this arena, RICS is a central stakeholder, and we look forward to working with the HM Treasury to reach a workable approach that supports economic and financial stability through the property valuation process.**

## About RICS

In order to inform our policy response, RICS hosted a roundtable with key stakeholders and members from the UK public sector property valuation sector on 20th April 2023.

Established in 1868, RICS is the largest organisation of its kind for professionals in property, construction, land, and related environmental issues, setting, and upholding professional standards for 125,000 qualified professionals and over 10,000 firms. RICS regulates both its individual qualified professionals and those firms that have registered for regulation by RICS.

Over 80,000 of our qualified professionals work in the UK, where our goal is to deliver a healthy and vibrant property and land sector as a key pillar of a thriving economy while addressing the need for the creation of green, safe communities.

Our professionals provide valuation services across many asset classes and work to the highest global standards that are underpinned by the regulatory scheme, Valuer Registration.

The Red Book is published by RICS in order to ensure high standards in valuation delivery worldwide, by our regulated members. The publication details mandatory practices for RICS members undertaking valuation services. It also offers a useful reference resource for valuation users and other stakeholders, ensuring that valuation assignments will be carried out in accordance with the most recent International Valuation Standards and providing assurance of consistency in approach.

We are not a trade body; we do not represent any sectional interest, and under the terms of our Royal Charter the advice and leadership we offer is always in the public interest.

# Key Points

A positive symbiotic relationship between real estate and the wider economy is vital in ensuring stability and prosperity throughout the country. Part of this critical connection is the valuation process. Valuations must be both objective and consistent to engender confidence and growth. Valuations touch every aspect of the property cycle, right from initial feasibility studies all the way through to property redevelopment and are a core ingredient of a robust real estate market and stable economy. Consistent, and reliable valuations are key to sound financial decision making (including loan origination), performance analysis, reviews, transactions and providing proper development advice.

Given the importance of valuations, any changes to the required valuation criteria for public sector financial reporting purposes must be done sensitively and in close co-operation with the valuation profession and all relevant stakeholders, to ensure that it is deliverable, workable and achieves its objectives. It is vital that moving forward there is certainty and a consistency of approach attached to any revised valuation framework. The new framework must be understood by both preparers and users of valuation, reducing the risk of uncertainties, which would have the potential of introducing unintended consequences that would impact the market detrimentally.

Whilst acknowledging the various issues which the proposals are ultimately seeking to address, there is a view from some of our members that the proposals appear to be attempting to solve problems associated with the audit system by changing the financial reporting framework which owing to the various underlying causes, may not ultimately be effective. Based on our members feedback, there has been an increase in regulatory audit pressures in recent years being passed down to external auditors to improve the reliability and accuracy of audits. This in turn has seen a significant increase in charge rates and time spent on audits. Valuation of tangible assets appears to be deemed an area of 'high risk' in the eyes of auditors in the preparation of financial accounts.

In some of our member's experience, external auditors are currently focussing more on Fair Value assets (Investment, Surplus and Assets Held For Sale) with less of a focus on Current Value assets (Specialised & Non-Specialised), so changes focused on the latter may not impact significantly.

There are also wider issues within Public Sector audit to contend with, which have not been addressed within the proposals such as profitability to auditors, availability of resources, and

skillset. The changes envisaged in the thematic review would not necessarily resolve the audit delay issues raised as the problems do not solely sit with the definitions of value currently being utilised.

In liaising with our members, a view had been expressed on the case for change from the current regime based on the cost factors involved. Some argued that the approximate £25 million per annum cost in respect of external valuations does not necessarily reflect poor value for money and which likely reflects as a very small proportion of the overall combined amount of asset valuations undertaken every year. From our discussions with representatives of major valuation firms, we are aware that that the proportion of valuer costs that is directly attributable to handling the ever more detailed audit queries being received has been steadily rising, with client costs similarly being inflated by the time they also spend dealing with auditor queries.

Looking at the bigger picture, we are aware that when and how to measure public sector assets is a subject which has been generating debate but little consensus for decades. During the 2000's, we are aware that the International Valuation Standards Committee set up various working parties with a view to developing a standard and/or guidance on the subject but its consultation drafts showed that there were such diametrically opposed systems between countries embedded in national legislation that there was no support for such a project, and it was abandoned.

One illustration of the diversity in approaches to measuring public sector approaches is in a 2013 study undertaken by the IMF, 'Another Look at Governments' Balance Sheets: The Role of Non-Financial Assets.'1 This found significant differences between major economies on what assets were measured and how they were measured.

In addition, we are aware that the International Public Sector Standards Accounting Board, which has been in existence since the 1980s, has a long running project aimed at identifying appropriate measurement principles but its forthcoming revised standard is likely to still permit a range of alternatives including cost and different valuation definitions.

Against this background, it can be seen there is no generally accepted right or wrong way of measuring public sector assets and that value and cost as measurement approaches both have their respective advantages and disadvantages.

Some of our members advise that valuable outputs and benefits (which are not always possible to accurately measure) arise from the annual asset valuation process, particularly the annual property inspections which provide invaluable information to users of valuations assisting in

[1] See IMF WP/13/95: https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Another-Look-at-Governments-Balance-Sheets-The-Role-of-Nonfinancial-Assets-40503

providing good property data and insights regarding property characteristics, condition and the environmental performance of an estate, as well as assisting in identifying costly and poor-quality properties for disposal. There is also a view from some of our public sector members acknowledging that current valuations play a key role in supporting the ongoing delivery of the Government's 2022 – 2030 property strategy [2] which aims to create a public sector estate which is more efficient, effective, and sustainable (supporting the Green Agenda), with its management being informed by good property data and insights regarding property characteristics and condition.

Undertaking regular valuations can be useful and informative for management. Valuations help guide the efficient use of resources and effective use of public capital when say deciding on refurbishments, repair budgets, disposals, and other property related decisions. Within the University sector, we note that when FRS 102 was adopted in 2015 and universities were given the option to move to historical cost or continue a Revaluation Policy, many chose to continue with valuations showing that they received a net benefit in despite the additional management overhead and cost.

Further management benefits from continuing with valuations are the ability to have depreciation charges that move in line with underlying values, and in broad terms in line with inflation rather than being held constant and becoming less relevant on a historical cost approach.

Valuations also allow clients to keep on top of their Asset Registers, which can become lacking in relevance or decipherability where multiple projects are being undertaken, some of which may involve demolitions or replacements of existing assets.

[2] See: https://www.gov.uk/government/publications/government-property-strategy-2022-2030#:~:text=The%020Government%20Property%20Strategy%202022,achieving%20better%20value%20for%20money..

## Next steps

In view of the above, RICS[3] is keen to discuss further and to work together with HM Treasury and other stakeholders to help shape solutions as you take steps to address the underlying issues of concern in public sector financial reporting and audit raised in your Review. As a reflection of this willingness, we have volunteered to be part of your recently initiated Working Group and attended your initial meeting of 5th May.

Ultimately, we appreciate that any further action needs to ensure an optimum balance of cost effectiveness and usefulness of outputs from the public sector non-investment valuation framework which ultimately uphold the public advantage. In addition, any changes in the valuation framework will need to be clearly understood and smoothly transitioned to by our members.

We set out below our more detailed responses to selected questions from the consultation paper. Please contact Jonathan Fothergill, Senior Specialist, Valuation and Investment Advisory, Standards Department at RICS via jfothergill@rics.org or +44 7790 826505 to discuss any of our submission further.

[3] See: Corporate Governance at RICS and Standards and Regulation Board (rics.org)

# Consultation responses to questions

We provide below our responses to your consultation questions from our perspective as the independent regulating professional body for property valuation in the UK.

### 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?

Yes: we broadly agree with the assessment and the pros and cons of the assessment you have provided for Option 1.

In consulting with our members on this Consultation, a key theme of feedback received has related to concerns of reverting to historical cost over current valuations as a form of measurement.

We note CIPFA's previously stated concerns relating to historic cost as a form of measurement as per their 1997 document, 1997 'Valuations for Accounting Purposes: A Guide for Public Services':

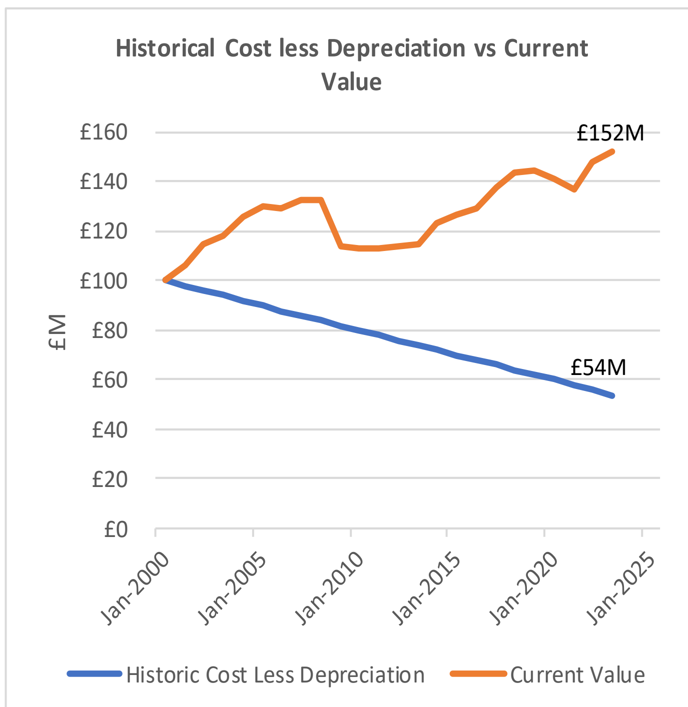
"*The case for the use of current asset values in public service bodies' financial statements is twofold. First, a system of accounting for assets, often acquired over several decades, on the basis of the cost prevailing at the time of their acquisition precludes comparability, both between different assets owned by the same organisation and between different organisations at any given time. Secondly, current values are intrinsically more relevant that historical costs for measuring the current financial position of an organisation and the current economic cost of using fixed assets in the provision of services."*

In terms of the case for comparability, we consider that this goes to the heart of transparency in public finance in public finance, and the accountability for the use of resources over time, and that current valuations are essential for this purpose. Further, balance sheet information that contains historical cost information rather than current value, provides only an indication of the organisation has spent to acquire the assets in the first place, plus what capital they have spent on it since acquisition, less any accumulated depreciation.  A balance sheet based on historical cost informs what capital has been spent rather than what capital is currently tied up into those assets. This information can inform strategic decision making through internal comparison of relative values and economic costs of different assets within the same service. It is unfortunate that such information is not being fully utilised by current users.

A common concern of our members is that if we revert to historical cost as the valuation basis, data quality around our property assets will deteriorate, as will investment in data systems,

impacting on our ability to manage these assets strategically. It is undoubtedly the case that the current framework of providing current valuations since 1994 has contributed to the amount and depth of information that had to be collected to support the annual valuation process. This information has been invaluable in the strategic management of property portfolios. Much of the data organisations now hold, might never have been collected if not for current values being needed for balance sheet purposes. The incentive to retain data will reduce if balance sheets move to historical cost, and this will impact on the quality of the property portfolio in many organisations. This can potentially have a detrimental effect on public sector customers and the quality of services delivered.

Section 3.35 of the Consultation Paper sets out some of the major issues with the Historical Cost Model compared to Current Values, the main one being that the disparity between the historical cost model and current values can be significant due to annual price changes. It may be beneficial to demonstrate this point with a simplistic practical example. For instance, a £100M public sector specialised asset which cost £100M to build in the year 2000, i.e. only 23 years old, would have fallen to a Net Book Value of £54M under a Historical Cost less depreciation model, assuming a 50 year depreciation policy. This would compare to £152M on a Current Value model taking BCIS TPI-All in as a proxy for value inflation and for ease, assuming identical depreciation. This represents an under representation of the true value of the asset by some -66%.



The difference would be even greater for longer periods of time. As a method for understanding the value of public sector specialised assets, historical cost would therefore struggle to comply with the 'Faithful Representation' principle. On these grounds, we would question the accuracy of the statement proffered under 4.24b of the Consultation that:

*"Changing the measurement basis to historical (deemed) cost is preferable because… this improves the reliability of the financial information reported."*

The speed at which the historical cost approach becomes worthless will be accelerated during high inflationary periods such as the one from which the UK is struggling to escape. Regular revaluations to current values have the benefit of keeping both land and buildings tied into the underlying value of money, whilst the historical cost approach cannot.

### 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?

Yes: we broadly agree with the assessment and the pros and cons of the assessment you have provided for Option 2.

Under the existing framework, UK public sector policy has required that "in use" operational assets be evaluated in light of the service potential and operational capacity they offer for carrying out their service role. The main driving force behind UK public sector financial reporting has, up until now, been that service potential rather than the opportunity cost of holding assets holding in terms of the cash flow that might be created through sale (which is what fair value assesses).

Whilst acknowledging issues and challenges in assessing valuations in such a way and in a Fair Value dominated financial reporting environment, RICS have recently developed and consulted with it members on new valuation guidance[4] intended to bring more understanding and consistency in our members approach to the EUV basis of valuation currently retained as a basis of measurement for operational properties in the UK public sector.

In view of this long-established existing framework, some of our public sector-based members have expressed concerns in transferring to adopting Fair Value as a basis for the valuation of operational assets in the public sector. We note that similar views are held also by some public sector-based members of the accounting profession including The International Public Sector Accounting Standards Board which you acknowledge within your paper as being in the process of developing a new global measurement basis entirely for public sector assets held for their operational capacity, called *current operational value*[5] which is the value of an asset used to

[4] See: https://consultations.rics.org/euv/view?objectID=13671956
[5] See: https://www.ipsasb.org/publications/exposure-draft-ed-78-property-plant-and-equipment

achieve the entity's service delivery objectives at the measurement date and in many aspects resembles EUV.

The objective of a Fair Value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.

We note that one of the Review's main concerns and objectives, is to address perceived difficulties with the valuation of specialised assets Adoption of a Fair Value basis for all operational properties, both Specialised and Non-Specialised. However, it is important to note that adoption of Fair Value for operational properties would not result in them all be valued using comparative market data, ending the reliance on DRC. IFRS 13 lists the Cost Approach as one of three valuation techniques permitted for Fair Value estimates, and that this is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence.[6] In addition, RICS, the International Valuation Standards Council (IVSC) and IPSASB all recognise DRC as being a valuation method rather than a valuation basis. It can be applied to arrive at any chosen valuation basis, including Fair Value, where sufficient relevant market transactions for identical or similar assets are not available [7]. Therefore, the Option 2 would not impact on the continued use of the DRC method for specialised operational assets.

A common concern with Fair Value is how the concepts of highest and best use (HABU) and maximising market participant data can be used when an asset is held for service delivery.

In the public sector, many assets are used for the delivery of services which may appear not to be their HABU. An example could be a school in a city centre. Some may view the HABU of the property as redevelopment for residential as this is the predominant use in the area and there is strong demand for more residential accommodation. However, there are criteria for establishing HABU in IFRS 13.[8] These include:

- that an alternative use must be legally permissible as well as physically possible and economically feasible
- the highest and best use might provide maximum value to market participants through its use in combination with other assets as a group.

Because a public authority will often have a statutory obligation to provide certain public services, designating land for the provision of such services is common under planning

[6] IFRS 13 62 and B8 and B9.

[7] See: https://www.rics.org/profession-standards/rics-standards-and-guidance/sector-standards/valuation-standards/depreciated-replacement-cost-method-of-valuation-for-financial-reporting

[8] IFRS 13 28 and 31

regulations.  Other uses may not therefore be legally permissible, so in the example above the current use as a school is the HABU unless there is a realistic possibility of planning consent for residential while it is still required as a school.  Other public services may require a network, or group, of properties for their delivery.  The value of any individual property for an alternative use may well be less than its value as part of the group, and therefore the HABU is the existing use.  Guidance on how HABU is to be assessed when applying IFRS Fair Value to public sector property held for service delivery may resolve some of the challenges identified.

The problem of limited observable market comparators for property held for service delivery remains, but IFRS 13 does allow Fair Value to be estimated using "unobservable inputs" so while this creates additional challenges it is not without precedent and has reflected in the drafting of IFRS 13.

The above issues may make the application of Fair Value difficult in a public sector context, not only to calculate the value but also to interpret the result. We understand that that such information may not be helpful to users of the financial statements since if an asset will never change its use, then why value it as something it cannot be used for?

On the other hand, some of our members believe that a move to Fair Value reporting in the UK public sector could assist in removing a great deal of uncertainty from year-end public sector valuations, seeing a greater use and reliance on this basis to inform wider estate decisions. There is also a thought amongst some that this is generally a more pragmatic and well understood basis of valuation in a Fair Value dominated financial reporting dominated environment.

Regarding the comment at para. 3.38 that additional time and effort may be required to identify the most advantageous market and determine HABU, we do not believe that the time and effort involved would necessarily be any greater than if any other measurement option was selected.  Anyone qualified to provide a valuation should have should readily be able to identify the most advantageous market.  We have acknowledged that some further guidance would be required on applying HABU concepts to property held for service delivery but do not believe that once this is in place that identifying HABU would normally involve significant additional work and certainly not extensive research.

### 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?

Yes:  whilst we broadly agree with the assessment you have provided in terms of the pros and cons of Option 3, we set out in our response to Question 12 more fully reasons why we generally disagree with HMT's assessment that Option 3 should be regarded as a preferred option

### 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?

Yes: it seems to make sense that land and buildings should be considered as their own asset category under any of the options HMT has presented given that they are tangible, long-term assets public sector entities use and benefit from over time.

Consideration also needs to be had as to whether land should be treated separately from buildings and also whether land should be assessed at fair value or existing use value.

We note that CIPFA finds it useful to feature the classification 'other land & buildings' in their Code of Practice to distinguish the majority of its operational property from its other bespoke classes of PP&E operational assets.

### 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?

Yes: we broadly agree with the assessment you have provided in respect of the pros and cons of Option 4a.

### 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?

Indexed cost could be applied to some designated asset classes in Option 3 but not all, especially in respect of the measurement of Non-Specialised assets where you are proposing Fair Value is applied.

### 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?

We consider that there are potential risks that Option 4a may not be considered true and fair owing to combining two different measurement bases for measuring assets.

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?

Yes: we broadly agree with the assessment you have provided in respect of the pros and cons of Option 4a.

We observe that this option involves the continued application of Current Value to all operational assets as under the Current Regime but that revaluations would be undertaken only quinquennially potentially leading to some cost savings, however this option could result in significant variations in value when revalued owing to the absence of interim updates.

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?

No because in Option 3 you are currently proposing a transition of Specialised assets from measurement by current value to historic cost, whereas Option 4 retains current value as a form of measurement.

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 consider that risks may arise in outputs being considered true and fair owing to the absence of interim updates between revaluations.

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?

It could be useful to understand what exactly was considered in terms of "a simplified revaluation model" and why these options are likely to result in significant departure from IFRS requirements.

In addition, it would be useful to see set out and evaluated in terms of the respective advantages and disadvantages, the option of 'doing nothing'.

Since we have not been provided with the Deloitte report in advance of preparing our response, we don't know what alternatives may have been considered before being rejected or the rationale behind them.

We note that the general concerns expressed in the Review relate to questions relating to the DRC approach of valuation for Specialised assets, the usefulness of outputs to users, the rising cost of valuations, the timeliness of audits and the failure of users to make good use of the outputs arising from the Current Regime.

Given that less observable market inputs are used , we acknowledge some issues associated with DRC and EUV types of valuations. Despite this, RICS have had longstanding valuation guidance in place for our members on the application of DRC[9] which we consider to be a valuation method rather than a valuation basis. This approach has long been recognised by the International Valuation Standards Council and others as an internationally recognised and appropriate valuation methodology and is also expressly permitted as a technique for estimating Fair Value under IFRS 13. In addition, RICS have recently developed and consulted on new valuation guidance [10] intended to bring more understanding and consistency in our members approach to the EUV basis of valuation.

In respect of DRC valuations, rather than moving away from this method and entirely changing the framework, an alternative option may be for HMT to look to work with the relevant stakeholders (RICS, CIPFA, leading government department and agencies) to better identify what has caused the present DRC concerns and find solutions to these issues. The UK public sector's problem with DRC arises from an absence of consistency, explicitness and transparency in how the DRC model is being applied. We note that much of the existing guidance relating to DRC generally sets out the high-level principles within which valuers must operate but does not provide prescription at the valuation process detail level.

### 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 generally disagree with HMT's assessment that Option 3 should be regarded as a preferred option, although we would caveat our response on the basis that like all of the set-out options, we can see both advantages and disadvantages to this option and we believe your own interpretation of these set out in the Consultation paper is fair and reasonable.

---

[9] See: https://www.rics.org/profession-standards/rics-standards-and-guidance/sector-standards/valuation-standards/depreciated-replacement-cost-method-of-valuation-for-financial-reporting

[10] See: (https://www.rics.org/profession-standards/consultations/euv

In particular, based on our consultation with our members, we disagree with Option 3's suggestion to divide operational assets into two different groups, each with its own measurement methodology. We believe practical categorization issues will arise as a result of this divergence. Given our separate finding that the justification for reintroducing the historic cost base is questionable (and which you have already previously ruled out in Option 1), we generally feel this option should be re-considered as a preferred one,

The aspect which we do agree with relating to this option are the proposals relating to Networked Assets, Heritage Assets, Social Housing Assets and Surplus Assets.

We note that it is proposed that Specialised PPE is measured at "historical deemed cost" and not DRC (which as per our response to Q2, RICS and others consider to be a method rather than basis), whereas a property deemed Non-Specialised is measured at Fair Value. The distinction between Specialised and Non-Specialised is not one that is easy to make and will vary depending on many variables, including the type of structure, location and market conditions and will involve judgement and subjectivity. Our understanding from your Consultation Paper is that the client entity would categorise each of its operational features as Specialist or Non-Specialised, depending on how they are thought to be used. We think this will lead to a variety of issues and could even result in more issues and inconsistencies than the solution it aims to provide. Although it could seem straight forward to ask entities to categorise properties that many properties' categorization may seem apparent, this is often not the case when one goes down to the level of practical application.

Currently, the valuer, not the client, decides whether or not an operating asset is Specialised, and for good reason. The valuer is in the best position to decide whether the DRC approach has to be used or if there is adequate, suitably comparable market transaction evidence that can be used. If that market evidence is absent, then a property cannot be considered Specialised or not. In addition, the market for some assets can change over time resulting in a change of categories. A technical complication of adopting historic cost based on the categorisation of assets between specialised and non-specialised is that assets can and often do change between the two. For instance, formerly specialised accommodation such as life sciences laboratories or hospital clinical accommodation may become traded as investors seek alternative sectors. This would lead to it being re-categorised as Non- Specialised. Conversely, a Non-Specialised office may have significant specialised adaptations works undertaken to convert it to a police station, school or university building that it can no longer be classed as an office and becomes Specialised. This review between Specialised and Non-Specialised would

need to be undertaken regularly on an asset by asset basis and would cause complications of moving individual assets from a revaluation policy to an historic cost policy and back again.

Another concern raised by our members relates to the NHS valuation framework. We consider that the suggested move away from DRC valuations to historic cost will undermine the NHS as it is currently the asset value that forms the basis of the PDC (charges paid by NHS to central Government) and depreciation charges that impact on maintenance budgets. The NHS also uses their valuations for their Estates information, to feed into business cases for new developments and to inform their Estate Strategies. We also note that there has also been no issue in the preparation and delivery of NHS accounts with audits completing in June, just three months after the 31 March year end despite most NHS estates comprising mainly of Specialised buildings valued by reference to DRC. We are also wary that a move away from established valuation methodologies could raise the risk profile around PFI and potential hand-back valuations with an inherent capex risk to the NHS.

The Review appears to be critical of the use of DRC valuations but then seeks to set the 2025 base valuation (where costs are not available) using DRC and we note also supports retaining its use for Networked assets.

Use of the DRC method appears to have been 'qualified' at 4.22 within the Consultation Paper. The DRC method is based on the economic principle of substitution, i.e. how much would it cost replace the asset including the land with a modern equivalent and then for the building element reflect the accumulated obsolescence. The DRC method therefore has a direct relevance to public sector entities such as hospitals who often do replicate the hypothetical steps from the DRC method by purchasing an alternative site and building modern facilities. The DRC figures therefore have more relevance than the alternative of adopting historical costs, especially with the compounding effects of inflation.

The review states at 4.16 (e) that "the distinguishing characteristics of networked assets in the public sector, such as long useful lives, complexity of componentisation and frequency of alterations support a DRC approach." For many public sector property classes such as hospitals this is also relevant, as many buildings have long useful lives; are often componentised across three or more components; and are often subject to significant capital expenditure to keep up with changing and increasing healthcare demands.

Another concern raised by members in respect of moving away from valuations to historic cost in respect of Specialised assets is that this will interfere with valuations required by public authorities for IFRS 16 implementation requirements. RICS has set out initial thoughts for its

members in its Practice Information [11] which suggests the use of existing DRC professional standard principles in the treatment of specialised assets.

A key point is a diminishing level of accountability in the public sector if re-valuations are lost for Specialised assets. The Government (and private sector) will need to significantly invest in their Specialised property assets to upgrade and replace parts of buildings with more sustainable components, or in some cases purchase new assets or demolish and build anew. During the next two decades when the majority of this work will need to be undertaken for the UK to hit its climate commitments now inscribed in law, it would be ill-judged to move the UK's Specialised public sector assets from regular revaluation to historical cost. Revaluations allow scrutiny of investment decisions and when considered by the relevant management bodies and, or local/national government this increases the efficient use of the nation's stretched public funds. Large impairments show where monies may have been misspent. These will go unnoticed if historical cost is adopted.

Whilst acknowledging the various audit related issues which the proposals are ultimately seeking to address, there is a view from some of our members that the proposals appear to be attempting to solve problems associated with the audit system by changing the financial reporting framework. Owing to the various underlying causes, this may not effectively address the issues identified by the Review, will create new difficulties and challenges, and will result in a loss of many of the benefits that flow from the Current Regime.

We believe that putting this option into practise runs the danger of reducing the relevance and reliability of an entity's financial statements. Furthermore, the comparability of financial statements will unavoidably be permanently lowered, both within an entity and between entities, as a result of the mixing of current value and historic cost data and the absence of a common base date for the historic cost data for each individual property.

### 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?

We are unable to comment from an expert accounting viewpoint but generally, yes: depreciated replacement cost would appear to be a logical measurement basis for valuing networked assets (whilst noting that you are proposing it is no longer used to value Specialised PPE). We note that the current exemption for local authority assets is retained.

[11] See: https://www.rics.org/news-insights/research-and-insights/ifrs-16-principles-for-uk-real-estate-professionals

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?**

Yes: we agree with the definition and note that this is taken from RICS' own definition.

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 accept that whilst there are advantages and disadvantages to cost and value approaches to measurement, there appears to be a general consensus view amongst our members that current valuations are preferable as a form of measurement in providing a more accurate and true assessment in financial statements relative to any form of historic cost (which you have ruled out in Option 1) and are also more useful as such.

We note that it is proposed that Specialised PPE is measured at "historical deemed cost" and not DRC (which as per our response to Q2, RICS and others consider to be a method rather than basis), whereas a property deemed Non-Specialised is measured at Fair Value. The distinction between Specialised and Non-Specialised is not one that is easy to make and will vary depending on many variables, including the type of structure, location and market conditions and will involve judgement and subjectivity. Our understanding from your Consultation Paper is that the client entity would categorise each of its operational features as Specialist or Non-Specialised, depending on how they are thought to be used. We think this will lead to a variety of issues and could even result in more issues and inconsistencies than the solution it aims to provide. Although it could seem straight forward to ask entities to categorise properties that many properties' categorization may seem apparent, this is often not the case when one goes down to the level of practical application.

Currently, the valuer, not the customer, decides whether or not an operating asset is Specialised, and for good reason. The valuer is in the best position to decide whether the DRC approach has to be used or if there is adequate, suitably comparable market transaction evidence that can be used. If that market evidence is absent, then a property cannot be considered Specialised or not. In addition, the market for some assets can change over time resulting in a change of categories. A technical complication of adopting historic cost based on the categorisation of assets between specialised and non-specialised is that assets can and often do change between the two. For instance, formerly specialised accommodation such as life sciences laboratories or hospital clinical accommodation may become traded as investors

seek alternative sectors. This would lead to it being re-categorised as Non-Specialised. Conversely, a Non-Specialised office may have significant specialised adaptations works undertaken to convert it to a police station, school or university building that it can no longer be classed as an office and becomes Specialised. This review between Specialised and Non-Specialised would need to be undertaken regularly on an asset by asset basis and would cause complications of moving individual assets from a revaluation policy to an historic cost policy and back again.

Another concern raised by our members relates to the NHS valuation framework. We consider that the suggested move away from DRC valuations to historic cost will undermine the NHS as it is currently the asset value that forms the basis of the PDC (charges paid by NHS to central Government) and depreciation charges that impact on maintenance budgets. The NHS also uses their valuations for their Estates information, to feed into business cases for new developments and to inform their Estate Strategies. We also note that there has also been no issue in the preparation and delivery of NHS accounts with audits completing in June, just three months after the 31 March year end despite most NHS estates comprising mainly of Specialised buildings valued by reference to DRC. We are also wary that a move away from established valuation methodologies could raise the risk profile around PFI and potential hand-back valuations with an inherent capex risk to the NHS.

The Review appears to be critical of the use of DRC valuations but then seeks to set the 2025 base valuation (where costs are not available) using DRC and we note also supports retaining its use for Networked assets.

Use of the DRC method appears to have been 'qualified' at 4.22 within the Consultation Paper. The DRC method is based on the economic principle of substitution, i.e. how much would it cost replace the asset including the land with a modern equivalent and then for the building element reflect the accumulated obsolescence. The DRC method therefore has a direct relevance to public sector entities such as hospitals who often do replicate the hypothetical steps from the DRC method by purchasing an alternative site and building modern facilities. The DRC figures therefore have more relevance than the alternative of adopting historical costs, especially with the compounding effects of inflation.

The review states at 4.16 (e) that "the distinguishing characteristics of networked assets in the public sector, such as long useful lives, complexity of componentisation and frequency of alterations support a DRC approach." For many public sector property classes such as hospitals this is also relevant, as many buildings have long useful lives; are often componentised across

three or more components; and are often subject to significant capital expenditure to keep up with changing and increasing healthcare demands.

Another concern raised by members in respect of moving away from valuations to historic cost in respect of Specialised assets is that this will interfere with valuations required by public authorities for IFRS 16 implementation requirements. RICS has set out initial thoughts for its members in its Practice Information [12] which suggests the use of existing DRC professional standard principles in the treatment of specialised assets.

A key point is a diminishing level of accountability in the public sector if re-valuations are lost for Specialised assets. The Government (and private sector) will need to significantly invest in their Specialised property assets to upgrade and replace parts of buildings with more sustainable components, or in some cases purchase new assets or demolish and build anew. During the next two decades when the majority of this work will need to be undertaken for the UK to hit its climate commitments now inscribed in law, it would be ill-judged to move the UK's Specialised public sector assets from regular revaluation to historical cost. Revaluations allow scrutiny of investment decisions and when considered by the relevant management bodies and, or local/national government this increases the efficient use of the nation's stretched public funds. Large impairments show where monies may have been misspent. These will go unnoticed if historical cost is adopted.

### 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?**

No. As set out at Q15, whilst we accept there are advantages and disadvantages to cost and value approaches to measurement, there appears to be a general consensus view amongst our members that current valuations are preferable as a form of measurement and ultimately are more useful and provide a more accurate and true assessment in financial statements relative to any form of historic 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?**

---

[12] See: https://www.rics.org/news-insights/research-and-insights/ifrs-16-principles-for-uk-real-estate-professionals

Generally, yes, we agree with the statement provided at para 4.25 of the paper, but perhaps “non-specialised” could be expanded by upon in terms of such properties not being unique in terms of specialised nature and design, configuration, size, location or otherwise.

### 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?

As per our response to Q2 implies, there are 2 possibilities here in terms of a valuation basis, namely:

- A valuation basis such as Fair Value and Market Value that reports the asset’s highest and best use which may be for an alternative use rather than the existing use, and therefore could represent an exit value, i.e. what the property could be sold for if it was no longer required for public service delivery, and:
- As per the Current Regime, a valuation basis such as EUV which ignores higher, potentially valuable uses and focuses on existing use and reflecting service potential.

RICS is neutral on which is the optimum basis and that this will ultimately depend on what the underlying public sector financial reporting objective is, and what valuation information would be most relevant to economic decision making.

Given its assumptions-based approach, we acknowledge some issues associated with EUV types of valuations. In response to member insight, RICS have recently developed and consulted on new valuation guidance [13]intended to bring more understanding and consistency in our members approach to the EUV basis of valuation.

### 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?

We agree there is no apparent reason to change from current measurement basis for these assets.

### 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?

We agree there is no apparent reason to change from current measurement basis for these assets.

---

[13] See: https://consultations.rics.org/euv/view?objectID=13671956

### 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 there is no apparent reason to change from current measurement basis for these assets.

### 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 there is no apparent reason to change from current measurement basis for these assets.

### 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?

This largely depends how you measure success for users of the account. Perhaps ultimately, they would benefit from receiving more timely publication of audited financial statements and at lower overall cost but given the proposal to revert Specialised assets to historic cost, we believe these outputs in particular will potentially be less meaningful and relevant.

Also, as per our response to Question 2, a common concern with Fair Value is that when an asset is held for its operational capacity, fair value is difficult to apply because the following concepts sometimes appear to conflict with the reality:

a) Highest and best use; and
b) Maximising the use of market participant data.

This may make the application of Fair Value difficult in a public sector context, not only to calculate the value but also to interpret the result.

At the same time, some of our members believe that a move to Fair Value reporting in the UK public sector could assist in removing a great deal of uncertainty from year-end public sector valuations, seeing a greater use and reliance on this basis to inform wider estate decisions. There is also a thought amongst some that this is generally a more pragmatic and well understood basis of valuation in a Fair Value dominated financial reporting dominated environment.

### 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 would refer you to our response to Q3 in which we set out some concerns relating to creating subclasses of Specialised and Non-Specialised PPE assets.

### 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?

Our response on this question generally depends on whether you proceed with Option 3 or not.

We feel that it can be useful to provide preparers with practical guidance relating to the differences between Network assets, Specialised and Non-Specialised assets.

Also, we would envisage that guidance may potentially be further required in the area of providing Fair Value to operational assets in view of our concern that some of these concepts do not seem relevant to assets being held in the public sector.

### 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?

Initial thoughts are that the later date of 2025-26 would appear more appropriate although we think the answer to this question should be determined by overall feedback from preparers and the auditing community. It would seem to make change to ultimately set a realistic date rather than a rushed date which is then subsequently put back.

### Question 27:

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

Please refer to our response to Question 26.

HM Treasury should be aware that if ultimately it is decided to proceed with Option 3, there may be additional costs arising in terminating external valuer’s valuation contracts.

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?

Broadly yes (if Option 3 is approved).

Question 29:

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

No

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.

No