



HM TREASURY

Financial Reporting Advisory Board Paper

ASSET VALUATION

Issue:	Giving greater freedom to entities in the way in which they meet the FRS 15 requirement to carry assets at value; aligning the text on FRS 11 with the changes to the Consolidated Budgeting Guidance; providing additional guidance on the interpretation for the public sector on depreciated replacement cost and asset valuation generally.
Impact on guidance:	Revised text for the 2007-08 FReM is attached at Annexes A and C; stand-alone guidance is attached at Annex E.
UK GAAP adaptation?	Yes (paragraphs 14 and 15 refer)
IAS/IFRS compliant?	No (paragraph 16 refers)
IPSAS compliant?	No (paragraph 17 refers)
Impact on budgetary regime?	No
Recommendation:	That the Board approve the amendments to the FReM in Annexes A and C and the guidance at Annex E.
Timing:	2007-08

DETAIL

Background

1. The Treasury has been working with a wide range of departments and with the devolved administrations in the Asset Valuation and Capital Charging Group (AVCCG) since mid 2005, looking at the impact of the existing accounting requirements for fixed assets and how they impact on entities' behaviours.

2. At an early stage in the process, the AVCCG (which comprised both accountants and valuers) discussed what it perceived to be the root causes of these issues. The following were identified:

- the site values assigned by the valuer when providing DRC valuations;
- the use of identical replacement cost (including the impact of DRC and modern replacements cost) by valuers;
- the difficulty in establishing functional obsolescence;
- the differing treatment of finance costs in valuation and accounting guidance;
- the impact of impairments;
- the difficulties involved in assessing building condition;
- the impact of indexation on asset values;
- the lack of consistency in the creation of the revaluation reserves for assets when resource accounting and budgeting commenced;
- the differing depreciation periods used by accountants and valuers for buildings; and
- existing use value vs. alternative use value.

3. Sub-groups were created to examine each of these issues. Each sub-group took away one or more issue and was asked to consider each afresh, without any pre-conditions: the terms of reference were that they consider the problem, identify its cause and propose solutions. The sub-groups' solutions fell broadly into three categories:

- those that required changes to the Royal Institution of Chartered Surveyors (RICS) Depreciated Replacement Cost (DRC) valuation guidance;
- those that required changes to HM Treasury's budgeting guidance; and
- those that required changes to HM Treasury's accounting guidance.

RICS DRC guidance

4. The RICS Public Sector Valuation Group (PSVG) had started work in December 2004 on a re-examination of the DRC guidance, and the AVCCG recognised that the outcome should address some of their concerns, particularly in relation to the apparent lack of consistent application of the guidance by different valuers. The PSVG's work has now culminated in the publication of a draft Valuation Information Paper (VIP 10) *The cost approach for financial reporting*. VIP 10, which is attached to this paper for information, provides supplementary information about the use of the cost approach for financial reporting as set out in IVSC Guidance Note 8 *The Cost Approach to Financial Reporting – (DRC) (Revised 2005)*. (Valuation standards are published by RICS in its 'Red Book' (RICS Appraisal and Valuation Standards)).

5. The PSVG felt that VIP 10, while encouraging changes in behaviours by both valuers and clients that would increase consistency of valuations, might not provide sufficient guidance for the public sector. Separate "Guidance on Valuations" has been produced, and is discussed later in this paper.

HM Treasury's budgeting guidance

6. The treatment of impairments has changed under the 2007-08 Consolidated Budgeting Guidance (CBG). In summary: those impairments that are within management control – losses or

damage resulting from normal business operations; abandonment of assets in the course of construction; and over specification of assets (gold plating) – will normally score as DEL. All other impairments will score as AME:

- loss as the result of a catastrophe;
- unforeseen obsolescence; and
- other impairments.

7. In addition, revaluation losses arising from movements in market prices and which are taken to the Operating Cost Statement will be scored as AME. (Impairment losses taken to reserves are “free” in resource terms.)

8. The budgeting treatment does not influence the accounting treatment. However, the revised text relating to FRS 11 suggests that entities might wish to consider whether information about the type and cause of the impairment could usefully be included in the relevant notes to the accounts. The impairment categories are defined in the CBG and in a separate document, which will be published on the FReM website. These are also attached for information (Annex F).

The accounting guidance

9. The main suggestion made by the sub-groups was that the requirement to index assets for the purpose of modified historical cost accounting (MHCA) should be withdrawn. However, the Treasury also considered valuation issues more widely, and have made the following proposals:

- to remove the adaptations (existing FReM 5.2.5 (a) and (b)) relating to interim valuations not being required; and
- to invoke paragraph 44 of FRS 15, under which public sector organisations might use alternative approaches to revaluations in arriving at a current value. The Treasury proposes, therefore, to require entities to value their estates using the most appropriate valuation methodology available in FRS 15, which might include a strict application of FRS 15 requirements; a quinquennial valuation supplemented by annual indexation and no interim professional valuation; annual valuations; or a rolling programme of valuations of properties (whether specialised or non-specialised).

10. The Treasury proposes that entities can choose to adopt a depreciated historical cost basis as a proxy for current valuations for assets that have short useful economic lives or low values (or both). For depreciated historical cost to be considered as a proxy for current value, the useful economic life must be a realistic reflection of the life of the asset and the depreciation method used must provide a realistic reflection of the consumption of that asset class.

11. More detail is provided in the separate “Guidance on Valuations”, which is attached at Annex E.

Guidance on valuations

12. The guidance comprises two parts. The first part supports VIP 10 by interpreting for the central government sector those requirements of the VIP that need to be explained further so that valuers and accountants achieve consistency (but not necessarily uniformity) across the many types of entity in the sector. This part should be read in conjunction with VIP 10. The sub-headings in this section of the guidance are the same as those in VIP 10 (where interpretation is required; not every part of

VIP 10 is discussed in the Guidance paper). In this section of the paper, there are three key requirements for the central government sector.

- a) The site value of the specialised property. Valuers routinely base site values of specialised property on a notional site – for example, a property on a site in central London might be valued as if it were located on the outskirts of London. The Treasury proposes to disallow this practice for entities covered by the FReM (since it does not reflect the economic reality of government policy) except where there is a clearly stated, and agreed, policy for relocation to other sites. Otherwise, entities should value the site that they occupy. This proposal is stricter than the requirements of the Red Book and VIP 10. This proposal means that, in general, entities will bear a cost of capital charge that reflects its actual property holdings and not an hypothetical alternative.
- b) Sources of cost information – phasing of works. VIP 10 requires valuers to have regard to various factors that affect the actual construction of a property – for example, the valuer may reflect the phasing of the work, the phasing of the payments (which means reflecting the time-value of money), and the finance charges incurred. The Treasury proposes to disallow this practice for entities covered by the FReM, and to continue with the existing requirement – which is to assume that the building is constructed ‘instantly’ and that the payments are made at balance sheet date. For the avoidance of doubt, entities should not capitalise the cost of capital charge or any other finance charge.
- c) Sources of cost information – optimal working conditions. In valuing a notional (alternative) site, the valuer will assume optimal working conditions. However, where an entity needs a valuation of the actual site it occupies, the Treasury proposes that the valuer be allowed to take into consideration any difficulties presented by that site through, for example, poor access.

13. The second part provides guidance on the valuation policy outlined in the FReM. This part should be read in conjunction with the FReM. It discusses the valuation of property assets, of non-property assets, and of enhancements.

- a) Entities are reminded that their balance sheets must give a true and fair view of the value of the assets at the balance sheet date, but that, within the constraints imposed by the FReM, entities are free to adopt practices that are most appropriate to their circumstances. Entities are permitted, but not required, to re-appraise the valuations of their properties using indices in the years between their quinquennial valuations. Interim valuations are not required where entities choose to use annual indexation.
- b) Entities can choose to adopt a depreciated historical cost basis as a proxy for current valuations in circumstances where, in their judgement, the difference between the depreciated historical cost and a revalued amount is likely to be immaterial or for categories of assets that are immaterial in terms of an entity’s total asset base. (For example, if the value of an entity’s estate represents 90% of its asset base, then the remaining assets might not be considered material). Examples of assets where this approach might be appropriate are motor vehicles, IT equipment, and furniture and fittings.

- c) There appear to be differing accounting treatments for enhancements of existing assets. For clarification, we propose that on the first valuation of the new asset created by an enhancement to an existing asset, the difference between the construction cost and the initial valuation of the new asset should be written off to the operating cost statement, in line with FRS 11.

UK GAAP compliance

14. The proposals remove two of the adaptations in the current text, the two adaptations remaining being the use of reserves for revaluation gains (and offsetting losses) and the charging of revaluation losses not caused by impairments to the revaluation (or other appropriate) reserve to the extent that there is sufficient cover. The interpretations of FRS 15 have been re-written to reflect the removal of the prescriptive approach to how entities should arrive at a valuation of their assets. Otherwise, they reflect existing practice.
15. The adaptations and interpretations of FRS 11 remain the same as in the current text, although some minor drafting changes have been made. The text now includes a section on 'other relevant factors', which has been added to reflect the changes to the budgetary treatment of impairments.

IAS/IFRS compliance

16. For the reasons given in paragraph 14, the proposals are not fully compliant with IAS 16 *Property, plant and equipment*. There are other differences between FRS 15 and IAS 16, and the Treasury's proposals will be brought to the Board at a later meeting, although the spirit of the changes proposed in this paper will be taken forward under IAS 16. The Treasury's proposals for IAS 36 *Impairments of assets* will also be considered in a separate paper, but, again, the changes proposed in this paper, linked to measures to ensure budgetary discipline, will feed through into the proposals on accounting for impairments.

IPSAS compliance

17. Given that IPSAS 17 *Property, plant and equipment* largely follows IAS 16, the proposals in this paper do not comply with IPSAS to the extent that they do not comply with IAS 16. Consideration of compliance with IPSAS 20 *Impairment of non-cash generating assets* is considered in the paper on IAS 36.

Proposed amendment to the Government Financial Reporting Manual

18. See Annex A for the proposed amendments relating to FRS 15 (existing text is in Annex B; the changes are extensive and tracked changes would have made the text difficult to read); and Annex C for amendments relating to FRS 11 (with the existing text in Annex D).

Impact on the budgetary regime

19. The proposals follow the budgetary regime.

Summary and recommendation

20. Following concerns raised by various departments (including some FRAB members), the Treasury formed an Asset Valuation and Capital Charging Group to consider those concerns and make recommendations for change where necessary. These changes embrace both budgeting and accounting, with the latter changes resulting in fewer adaptations of FRS 15. In addition, the Treasury has participated in the development of the Valuation Information Paper 10 (*The Cost Approach for Financial Reporting*) by the Royal Institution of Chartered Surveyors (now published as an exposure draft) and has developed additional guidance for entities whose properties are valued on a depreciated replacement cost basis.
21. The Board is invited to approve the changes.

HM Treasury

12 February 2007

PROPOSED AMENDMENT TO THE GOVERNMENT FINANCIAL REPORTING MANUAL FOR FRS 15

5.2 Tangible fixed assets

5.2.1 The following accounting standards and UITF Abstracts deal with accounting for tangible fixed assets:

FRS 15 Tangible fixed assets (paragraphs 5.2.2 to 5.2.23);

SSAP 19 Investment properties (paragraphs 5.2.24 and 5.2.25);

FRS 5 Reporting the substance of transactions (paragraphs 5.2.26 to 5.2.29);

SSAP 21 Accounting for leases and hire purchase contracts (paragraphs 5.2.30 and 5.2.31);

FRS 11 Impairment of fixed assets and goodwill (paragraphs 5.2.32 to 5.2.36);

SSAP 4 Accounting for government grants (paragraphs 5.2.37 to 5.2.41);

UITF Abstract 5 Transfers from current assets to fixed assets (chapter 6);

UITF Abstract 24 Accounting for start up costs (paragraphs 5.2.42 and 5.2.43);

UITF Abstract 28 Operating lease incentives (paragraphs 5.2.44 and 5.2.45);

UITF Abstract 29 Website development costs (paragraphs 5.2.46 to 5.2.48); and

UITF Abstract 31 Exchanges of businesses or other non-monetary assets for an interest in a subsidiary, joint venture or associate (paragraphs 5.2.49 to 5.2.51).

UITF Abstract 23 (Application of the transitional rules in FRS 15) is not likely to be relevant and is not discussed further in this Manual. However, if it is applicable, it should be applied in full.

FRS 15 Tangible fixed assets

Applicability

5.2.2 FRS 15 applies, as adapted in paragraph 5.2.5, to all entities covered by this Manual. Owing to their importance to the entities covered by the requirements of this Manual, separate guidance is included on:

infrastructure assets (paragraphs 5.2.9 to 5.2.12);

donated assets (paragraphs 5.2.13 to 5.2.17);

asset transfers (paragraph 5.2.18); and

heritage assets (paragraphs 5.2.19 to 5.2.23).

5.2.3 A worked example of accounting for a fixed asset using modified historical cost accounting and guidance on valuation issues are provided on the Manual's dedicated web site. Additional *Guidance on Asset Valuation* is also available on the web site.

Objectives of FRS 15

5.2.4 The objectives of FRS 15 are to ensure that consistent principles are applied to the initial measurement of tangible fixed assets, that valuations are performed on a consistent basis, kept up-to-date with gains and losses on revaluation being treated consistently, that depreciation is calculated consistently and recognised over the assets' useful lives, and that sufficient information is disclosed in the financial statements to enable users to understand the impact of an entity's accounting policies regarding measurement, valuation and depreciation of tangible fixed assets on the financial position and performance of the entity.

Adaptation of FRS 15 for the public sector context

5.2.5 The following general adaptations to FRS 15 apply to entities required to prepare their financial statements in accordance with the guidance in this Manual.

Recognition and measurement

- a) Gains on revaluation of fixed assets should be credited to the relevant reserve as follows:

Assets financed by grants in aid - the revaluation reserve (7.4.58)

Donated assets – the donated asset reserve (7.4.59)

Assets financed by grants, including any from the EU – the government grant reserve (7.4.60)

- b) Losses on revaluation (other than impairment losses reflecting losses of economic benefits (see FRS 11)) should be debited to the relevant reserve (see above) to the extent that gains have been recorded previously, and otherwise to the operating cost statement, unless it can be demonstrated that the recoverable amount is greater than the revalued amount in which case the impairment can be taken to the statement of recognised gains and losses.

Interpretations of FRS 15 for the public sector context

5.2.6 In applying FRS 15, entities should be aware of the following general interpretations for the public sector context.

Recognition and measurement

- a) All tangible fixed assets shall be carried at valuation so as to give a true and fair view of the value of those assets at the balance sheet date – that is, the option given in FRS 15 to measure at cost has been withdrawn, as has the option to value only certain classes of assets.

- b) It is not necessary to disclose the historical cost carrying amounts (where available) as required by FRS 15.
- c) Tangible fixed assets should be valued at the lower of replacement cost and recoverable amount, which is the higher of net realisable value or value in use. Where an entity cannot measure value in use in terms of income, value in use should be assumed to be at least equal to the cost of replacing the service potential provided by the asset (subject to any impairment of that service potential).
- d) Entities shall not capitalise any finance costs that are directly attributable to the construction of tangible fixed assets.

Valuations

5.2.7 In considering how best to apply the valuation requirements of FRS 15 so as to ensure that the balance sheet gives a true and fair view of the value of the assets at the balance sheet date, entities should consider the following guidance on property and non-property assets. (More detailed guidance is available on this Manual's dedicated web site.)

Property

Recognition and measurement

- a) Entities should value their estates using the most appropriate valuation methodology available in FRS 15. Such methods might include:
 - the approach set out in paragraphs 42 to 62 of FRS 15;
 - a quinquennial valuation supplemented by annual indexation and no interim professional valuation;
 - annual valuations; or
 - a rolling programme of valuations of properties (whether specialised or non-specialised).
- b) It is for valuers, using the Royal Institution of Chartered Surveyors' (RICS) 'Red Book' (RICS Appraisal and Valuation Standards), and following discussions with the entity, to determine the most appropriate methodology for valuing property. Where a valuer, following discussion with the entity, determines that a cost approach (otherwise known as depreciated replacement cost (DRC)) is the most appropriate, entities and their valuer should have regard to the RICS Valuation Information Paper No. 10 The Cost Approach for Financial Reporting, as supplemented by the additional guidance available on this Manual's dedicated web site.
- c) Where DRC is used as the valuation methodology, entities should normally value a modern equivalent asset in line with the Red Book. An entity should discuss with the relevant authority (through sponsoring bodies where appropriate) any plans to value a reproduction of the existing asset and determine whether such an approach is appropriate to the entity's circumstances.

- d) The cost of enhancements to existing assets (such as the building of a new wing within an existing prison or adding a lane to a motorway) should be capitalised during the construction phase as an asset under construction. At the first valuation after the asset is brought into use, any write down of cost should be treated as an impairment and charged to the operating cost statement.

Disclosure

- e) Entities should:
- disclose in the accounting policies note: the fact that assets are carried at valuation in existing use. Entities should provide information about the approach to valuing their estates, including a statement (where applicable) that alternative sites have been used in drc valuations as a result of a relocation programme;
 - disclose in the notes on tangible fixed assets: the dates of the last valuations of those property assets that are subject to revaluation and the names and qualifications of the valuer; and
 - discuss in the Management Commentary, where they hold extensive estates: their estate management strategies; the indicative alternative use values provided by the valuer as part of the routine valuation work, and what those alternative use values mean in terms of their estate management policy.

Non-Property

Recognition and measurement

- f) Entities may elect to adopt a depreciated historical cost basis as a proxy for current valuations for assets that have short useful economic lives or low values (or both). For depreciated historical cost to be considered as a proxy for current value, the useful economic life must be a realistic reflection of the life of the asset and the depreciation method used must provide a realistic reflection of the consumption of that asset class.
- g) Assets that are not covered by the above paragraph should be carried at current value. Entities should value such assets using the most appropriate valuation methodology available in FRS 15.

Disclosure

- h) Entities should disclose the following in the notes to their accounts in relation to the valuation of non-property assets:

in the accounting policies note: the fact that assets are carried at valuation in existing use; that depreciated historical cost is used as a proxy for current value for named classes of assets (where appropriate) and the reasons why; information about any significant estimation techniques (where applicable);

in the notes on tangible fixed assets: the dates of the last valuations of any non-property assets that are subject to revaluation and the names and qualifications of the valuer.

Other requirements

5.2.8 The following requirements should be observed by entities covered by this Manual.

- a) Following the annual review of the economic useful lives of assets or asset categories required by FRS 15, entities should discuss any significant proposals to change these lives with the relevant authorities (through sponsoring bodies where appropriate) to ensure that the budgeting implications have been properly considered.
- b) Entities might from time to time review their capitalisation thresholds or asset measurement methods. Any proposals for significant change to either must be discussed with the relevant authorities (through sponsoring bodies where appropriate) to ensure that the budgeting implications have been properly considered.

Infrastructure assets

5.2.9 Infrastructure assets comprise assets that form part of an integrated network servicing a significant geographical area – for example, road networks.

Adaptation of FRS 15 in respect of accounting for roads

5.2.10 Renewals accounting as applied to roads is an adaptation of FRS 15. The relevant authorities have determined that renewals accounting as set out in FRS 15 shall be used as a method of estimating depreciation for infrastructure assets, even where entities do not calculate the level of annual maintenance expenditure by reference to an asset management plan.

5.2.11 The road network is carried on the balance sheet at current replacement cost, adjusted to reflect the condition of the network. A full valuation of the network shall be undertaken at least every five years, supplemented by annual condition surveys. The condition surveys must be undertaken on a consistent basis and cover a significant and representative proportion of the road network. All renewals expenditure should be charged to the operating cost statement. If a condition survey reveals that the network has been maintained in a steady state since the previous survey, then no depreciation charge is required. However, if the condition of the network has deteriorated/improved between condition surveys, the value of the deterioration/improvement, if material, should be charged/credited to the operating cost statement and the carrying value of the assets adjusted accordingly.

5.2.12 In the years between the full valuations, the value of the network should be adjusted to reflect:

- a) material movements in prices using appropriate published indices;
- b) any expenditure on new schemes or enhancements which increase the capacity of the network in line with the treatment of enhancements to existing assets set out in paragraph 5.2.7 (c); and
- c) detrunkings. Detrunings should be accounted for as disposals of assets for no consideration.

ANNEX B

EXISTING WORDING IN THE GOVERNMENT FINANCIAL REPORTING MANUAL FOR FRS 15

5.2 *Tangible fixed assets*

5.2.1 The following accounting standards and UITF Abstracts deal with accounting for tangible fixed assets:

FRS15 *Tangible fixed assets* (paragraphs 5.2.2 to 5.2.22);

SSAP19 *Investment properties* (paragraphs 5.2.23 and 5.2.24);

FRS5 *Reporting the substance of transactions* (paragraphs 5.2.25 to 5.2.28);

SSAP21 *Accounting for leases and hire purchase contracts* (paragraphs 5.2.29 and 5.2.30);

FRS11 *Impairment of fixed assets and goodwill* (paragraphs 5.2.31 to 5.2.35);

SSAP4 *Accounting for government grants* (paragraphs 5.2.36 to 5.2.40);

UITF Abstract 5 *Transfers from current assets to fixed assets* (chapter 6);

UITF Abstract 24 *Accounting for start up costs* (paragraphs 5.2.41 and 5.2.42);

UITF Abstract 28 *Operating lease incentives* (paragraphs 5.2.43 and 5.2.44);

UITF Abstract 29 *Website development costs* (paragraphs 5.2.45 to 5.2.47); and

UITF Abstract 31 *Exchanges of businesses or other non-monetary assets for an interest in a subsidiary, joint venture or associate* (paragraphs 5.2.48 to 5.2.50).

UITF Abstract 23 (*Application of the transitional rules in FRS15*) is not likely to be relevant and is not discussed further in this Manual. However, if it is applicable, it should be applied in full.

FRS 15 Tangible fixed assets

Applicability

5.2.2 FRS15 applies, as adapted in paragraph 5.2.5, to all entities covered by this Manual. Owing to their importance to the entities covered by the requirements of this Manual, separate guidance is included on:

infrastructure assets (paragraphs 5.2.8 to 5.2.11);

donated assets (paragraphs 5.2.12 to 5.2.16);

asset transfers (paragraph 5.2.17); and
heritage assets (paragraphs 5.2.18 to 5.2.22).

5.2.3 A worked example of accounting for a fixed asset using modified historical cost accounting is provided.

Objectives of FRS15

5.2.4 The objectives of FRS15 are to ensure that consistent principles are applied to the initial measurement of tangible fixed assets, that valuations are performed on a consistent basis, kept up-to-date with gains and losses on revaluation being treated consistently, that depreciation is calculated consistently and recognised over the assets' useful lives, and that sufficient information is disclosed in the financial statements to enable users to understand the impact of an entity's accounting policies regarding measurement, valuation and depreciation of tangible fixed assets on the financial position and performance of the entity.

Adaptation of FRS15 for the public sector context

5.2.5 The following general adaptations to FRS15 apply to entities required to prepare their financial statements in accordance with the guidance in this Manual.

Recognition and measurement

- a) Interim valuations by a qualified valuer of land and buildings in the third year of every five-year valuation cycle are not required.
- b) Interim valuations by a qualified valuer of tangible fixed assets other than land and buildings are not required.
- c) Gains on revaluation of fixed assets should be credited to the relevant reserve as follows:
 - Assets financed by grants in aid - the revaluation reserve (7.4.58)
 - Donated assets – the donated asset reserve (7.4.59)
 - Assets financed by grants, including any from the EU– the government grant reserve (7.4.60)
- d) Losses on revaluation (other than impairment losses reflecting losses of economic benefits) should be debited to the relevant reserve (see c above) to the extent that gains have been recorded previously, and otherwise to the operating cost statement, unless it can be demonstrated that the recoverable amount is greater than the revalued amount in which case the impairment can be taken to the statement of recognised gains and losses.

Interpretations of FRS15 for the public sector context

5.2.6 In applying FRS15, entities should be aware of the following interpretations for the public sector context.

Recognition and measurement

- a) All tangible fixed assets shall be carried at valuation at balance sheet date – that is, the option given in FRS15 to measure at cost has been withdrawn, as has the option to value only certain classes of assets.
- b) It is not necessary to disclose the historical cost carrying amounts (where available) as required by FRS15.
- c) Land and buildings should be subject to valuation by a qualified valuer at intervals of not more than five years and should be adjusted in each intervening year by using appropriate indices or other recognised, appropriate method.
- d) Indices or other appropriate information sources should be used to determine the annual gross valuation of tangible fixed assets other than land and buildings where it is not possible or not cost effective to obtain a professional valuation.
- e) Tangible fixed assets should be valued at the lower of replacement cost and recoverable amount, which is the higher of net realisable value or value in use. Where an entity cannot measure value in use in terms of income, value in use should be assumed to be at least equal to the cost of replacing the service potential provided by the asset (subject to any impairment of that service potential).
- f) Entities shall not capitalise any finance costs that are directly attributable to the construction of tangible fixed assets.

Other requirements

5.2.7 The following requirements should be observed by entities covered by this Manual.

- a) Following the annual review of the economic useful lives of assets or asset categories required by FRS15, entities should discuss any significant proposals to change these lives with the relevant authorities (through sponsoring bodies where appropriate) to ensure that the budgeting implications have been properly considered.
- b) Entities might from time to time review their capitalisation thresholds or asset measurement methods. Any proposals for significant change to either must be discussed with the relevant authorities (through sponsoring bodies where appropriate) to ensure that the budgeting implications have been properly considered.

Infrastructure assets

5.2.8 Infrastructure assets comprise assets that form part of an integrated network servicing a significant geographical area – for example, road networks.

Adaptation of FRS15 in respect of accounting for roads

5.2.9 Renewals accounting as applied to roads is an adaptation of FRS15. The relevant authorities have determined that renewals accounting as set out in FRS15 shall be used as a method of estimating depreciation for infrastructure assets, even where entities do not calculate the level of annual maintenance expenditure by reference to an asset management plan.

5.2.10 The road network is carried on the balance sheet at current replacement cost, adjusted to reflect the condition of the network. A full valuation of the network shall be undertaken at least every five years, supplemented by annual condition surveys. The condition surveys must be undertaken on a consistent basis and cover a significant and representative proportion of the road network. All renewals expenditure should be charged to the operating cost statement. If a condition survey reveals that the network has been maintained in a steady state since the previous survey, then no depreciation charge is required. However, if the condition of the network has deteriorated/improved between condition surveys, the value of the deterioration/improvement, if material, should be charged/credited to the operating cost statement and the carrying value of the assets adjusted accordingly.

5.2.11 In the years between the full valuations, the value of the network should be adjusted to reflect:

- a) movements in prices using appropriate published indices;
- b) any expenditure on new schemes or enhancements which increase the capacity of the network;
- c) detrunkings.

PROPOSED AMENDMENT TO THE GOVERNMENT FINANCIAL REPORTING MANUAL FOR FRS 11

FRS 11 Impairment of fixed assets and goodwill

Applicability

5.2.31 FRS 11 applies, as adapted in paragraph 5.2.34, to all entities covered by this Manual.

5.2.32 The worked example of accounting for a fixed asset under modified historical cost accounting includes the accounting entries required when the asset is impaired.

Objectives of FRS 11

5.2.33 The objectives of FRS 11 are to ensure that fixed assets and goodwill are recorded in the financial statements at no more than their recoverable amount and that any resulting impairment loss is measured and recognised on a consistent basis. In addition, sufficient information should be disclosed in the financial statements to enable users to understand the impact of the impairment on the financial position and performance of the reporting entity.

Adaptation of FRS 11 for the public sector context

5.2.34 The following adaptations to FRS 11 apply to the non-profit making activities of entities required to prepare their financial statements in accordance with the guidance in this Manual. Entities should apply FRS 11 without adaptation to any income-generating activities.

Recognition and measurement

- a) References in FRS 11 to the statement of total recognised gains and losses should be read to mean the revaluation (or donated asset or government grant) reserve. Only those impairment losses that do not result from a loss of economic value or service potential should be taken to reserves. Where such losses, which will generally be as a result of downward price movements, are taken to one of the reserves, it should be to the extent only that there is a credit value in the reserve relating to the impaired asset and only until the carrying value becomes equal to the depreciated historical cost. (For this purpose, 'historical cost' means the value at which an asset was taken on to the fixed asset register if no historical cost is otherwise available.) All losses that are a result of a loss of economic value or service potential should be taken to the operating cost statement.
- b) Impairment charges in excess of the credit in the revaluation or other reserve or that lead to a reduction in value to below the depreciated historical cost should be charged to the operating cost statement unless it can be demonstrated that the recoverable amount is greater than the revalued amount in which case the impairment can be taken to the statement of recognised gains and losses. For the recoverable amount to be greater than the revalued amount, entities must demonstrate that:

- I. they are not aware of any factors that have caused a substantial fall in usage or decline in the condition of the asset – that is, that the fall in value has not been caused by a consumption of economic benefits;
- II. for assets valued on an existing use value or other market-based valuation, the reduction is due to a short-term reduction in market prices, which informed opinion believes will be reversed in the medium term; or
- III. for assets valued on a depreciated replacement cost basis, changes in technology in the relevant sector are small, so that any downward movement in prices is likely to be short-term, as there are no noticeable improvements in technology or sustained falls in commodity prices that would cause prices to fall over the medium term.

Interpretation of FRS 11 for the public sector context

5.2.35 In applying FRS 11, entities should be aware of the following interpretations for the public sector context.

Recognition and measurement

- a) Where an asset is not held for the purpose of generating cash flows, value in use should be assumed to be equal to the cost of replacing the service potential provided by the asset, unless there has been a reduction in service potential.
- b) A reduction in service potential might arise for various reasons, including:
 - I. the purpose for which the asset was acquired is no longer carried out and there is no alternative use for the asset;
 - II. the asset is to be sold;
 - III. the asset cannot be used;
 - IV. the asset is otherwise surplus and has no alternative use; or
 - V. the asset is over-specified for its current use (for example, a hardened aircraft hangar used as a store).
- c) Where there is a reduction in service potential, the asset will be written down to its recoverable amount, with the impairment being charged to the operating cost statement. In the case of I to IV above, the recoverable amount will be the asset's net realisable value – that is, the amount at which the asset could be disposed of, less any disposal costs. In the case of the example in V, the net realisable value will relate to the store – that is, not to the over-specification.

Other relevant factors

- d) In budgetary terms, certain impairments will score as DEL and others as AME, and departments will enter the type of impairment onto COINS using the relevant account code. The Consolidated Budgeting Guidance contains more detail. The budgeting treatment does not influence the accounting treatment, but entities might wish to consider whether information about the type and cause of the impairment could

usefully be included in the relevant notes to the accounts. Impairment categories, which are defined in separate guidance on this Manual's website, are:

Loss or damage resulting from normal business operations

Loss as the result of a catastrophe

Abandonment of assets in the course of construction

Unforeseen obsolescence

Over specification of assets (gold plating)

Other impairments

- e) Capitalised development expenditure that is directly linked to tangible fixed assets (for example, development expenditure related to a fleet of aircraft) should be impaired in the following circumstance: where the entire fleet is impaired, then the development expenditure should be impaired proportionately. (That is, if less than the whole fleet is impaired, there is no impairment of the related intangible asset.)

ANNEX D

EXISTING WORDING IN THE GOVERNMENT FINANCIAL REPORTING MANUAL FOR FRS 11

FRS 11 Impairment of fixed assets and goodwill

Applicability

- 5.2.31 FRS11 applies, as adapted in paragraph 5.2.34, to all entities covered by this Manual.
- 5.2.32 The worked example of accounting for a fixed asset under modified historical cost accounting includes the accounting entries required when the asset is impaired.

Objectives of FRS11

- 5.2.33 The objectives of FRS11 are to ensure that fixed assets and goodwill are recorded in the financial statements at no more than their recoverable amount and that any resulting impairment loss is measured and recognised on a consistent basis. In addition, sufficient information should be disclosed in the financial statements to enable users to understand the impact of the impairment on the financial position and performance of the reporting entity.

Adaptation of FRS11 for the public sector context

- 5.2.34 The following adaptations to FRS11 apply to the non-profit making activities of entities required to prepare their financial statements in accordance with the guidance in this Manual and that are not engaged in profit-making activities. Entities should apply FRS11 without adaptation to any income-generating activities.

Recognition and measurement

- a) References in FRS11 to the statement of total recognised gains and losses should be read to mean the revaluation (or donated asset or government grant) reserve. Where impairment losses are taken to one of the reserves, it should be to the extent only that there is a credit value in the reserve relating to the impaired asset and only until the carrying value becomes equal to the depreciated historical cost. (For this purpose, 'historical cost' means the value at which an asset was taken on to the fixed asset register if no historical cost is otherwise available.)
- b) Downward revaluations in excess of the credit in the revaluation or other reserve or leading to a reduction in value to below the depreciated historical cost should be charged to the operating cost statement unless it can be demonstrated that the recoverable amount is greater than the revalued amount in which case the impairment can be taken to the statement of recognised gains and losses. For the recoverable amount to be greater than the revalued amount, entities must demonstrate that:

- I. they are not aware of any factors that have caused a substantial fall in usage or decline in the condition of the asset – that is, that the fall in value has not been caused by a consumption of economic benefits;
- II. for assets valued on an existing use value or other market-based valuation, the reduction is due to a short-term reduction in market prices, which informed opinion believes will be reversed in the medium term; or
- III. for assets valued on a depreciated replacement cost basis, changes in technology in the relevant sector are small, so that any downward movement in prices is likely to be short-term, as there are no noticeable improvements in technology or sustained falls in commodity prices that would cause prices to fall over the medium term.

Interpretation of FRS11 for the public sector context

5.2.35 In applying FRS11, entities should be aware of the following interpretations for the public sector context.

Recognition and measurement

- a) Where an asset is not held for the purpose of generating cash flows, value in use should be assumed to be equal to the cost of replacing the service potential provided by the asset, unless there has been a reduction in service potential.
- b) A reduction in service potential might arise for various reasons, including:
 - I. the purpose for which the asset was acquired is no longer carried out and there is no alternative use for the asset;
 - II. the asset is to be sold;
 - III. the asset cannot be used;
 - IV. the asset is otherwise surplus and has no alternative use; or
 - V. the asset is over-specified for its current use (for example, a hardened aircraft hangar used as a store).
- d) Where there is a reduction in service potential, the asset will be written down to its recoverable amount, with the impairment being charged to the operating cost statement. In the case of I to IV above, the recoverable amount will be the asset's net realisable value – that is, the amount at which the asset could be disposed of, less any disposal costs. In the case of the example in V, the net realisable value will relate to the store – that is, not to the over-specification.

GUIDANCE ON ASSET VALUATION

Introduction

This guidance should be read in conjunction with the text in the Government Financial Reporting Manual (FReM) about the application of FRS 15 by entities covered by the requirements of the FReM. It has been developed with the assistance of a Working Group set up to consider issues around asset valuation and capital charging. Separate from, but critical to, the Working Group's deliberations was the review by the Royal Institution of Chartered Surveyors' (RICS) Public Sector Valuation Group (PSVG) of its guidance on preparing valuations using the depreciated replacement cost methodology. RICS has now published its Valuation Information Paper (No 10) The Cost Approach for Financial Reporting. This guidance interprets that Valuation Information Paper for the particular circumstances faced by the entities covered either directly by the FReM or by guidance derived from the FReM (for example, the NHS Manuals of Accounts).

This guidance does not address the valuation of Heritage Assets. Separate guidance on Heritage Asset Valuation is being developed.

This guidance covers two areas: Valuation Information Paper No 10; and valuation policy.

Valuation Information Paper No. 10: The Cost Approach for Financial Reporting

- 1.1. This section of the guidance supports Valuation Information Paper (VIP) No. 10 by interpreting for the central government sector those requirements of the VIP that need to be explained further so that valuers and accountants achieve consistency (but not uniformity) across the many types of entity in the sector.
- 1.2. VIP No. 10 provides supplementary information about the use of the cost approach for financial reporting as set out in IVSC Guidance Note 8 The Cost Approach to Financial Reporting – (DRC) (Revised 2005). (Valuation standards are published by RICS in its 'Red Book' (RICS Appraisal and Valuation Standards)). The terms 'Cost Approach' and 'depreciated replacement cost' (DRC) are considered to be synonymous, since both are in common use world-wide to describe the same valuation technique. The VIP is available from RICS at [insert relevant address once obtained from RICS].
- 1.3. This part of the guidance follows the order of the VIP for ease of access, although it does not comment on all the sections of the VIP. Paragraph references are to VIP paragraphs.

When is DRC used?

DRC is a valuation method of last resort

- 1.4. DRC should only be used as a last resort. It should be used only where there is no useful or relevant evidence of recent market transactions due to the specialised nature of the asset (paragraph 3.1). The specialised nature may be a result of the size or location of the asset, as well as the service provided. But it does not follow that, where DRC has been the valuation method in the past, it remains

appropriate to use DRC for the latest valuation, since there might be sufficient evidence of an emerging market; the VIP gives the healthcare and leisure sectors as examples.

- 1.5 Some specialised assets in the central government sector may generate material cash flows; these specialised assets should be valued by the income or profits test approach.

Buildings of conventional appearance that have specialised features

- 1.6 VIP 10 notes that there will be some buildings that have a conventional basic design that is superficially similar to other buildings that are regularly bought and sold in the market, but on closer inspection have specialised features designed to meet the requirements of the actual occupier.
- 1.7 A typical example of this is a purpose-built embassy, which, although built to perform an office function, is situated on a site that includes extra stand-off land and includes designed-in security features such as thickened walls and toughened glazing. This type of building will often cost considerably more to develop and build than a normal office building, but provide extra service potential (in the form of security for its occupants) which cannot be replicated through the purchase of a normal office building.
- 1.8 In these instances, provided that the occupying entity continues to require the extra service potential, it is likely that the building should be treated as specialised and valued to DRC with full account taken of the extra cost of the specialised features and requirement for stand-off land.

Buildings that include specialised adaptations

- 1.9 Some buildings will comprise conventional structures that have been adapted to the requirement of the occupier. For example, a commercial office building may have been purchased by a government department and adapted by provision of enhanced security features such as perimeter barriers or toughened glazing. Where an entity has opted to treat the cost of such specialised adaptations as a separate item in its financial statements, the valuer will value the conventional building (paragraph 3.9). Where the entity has not accounted for the costs of adaptation separately, the valuer will need to consider whether the adaptations are such that the building meets the definition of a specialised property (paragraph 3.10).
- 1.10 Central government entities can choose whether or not to account for adaptations as a separate item in their financial statements. As a guide, while specialised features designed-in to purpose-built buildings should normally be accounted for as part of the whole building, adaptations to existing buildings should normally be accounted for separately.
- 1.11 Where an entity opts to account for the costs of the adaptations as a separate item, those costs should be depreciated over a maximum of the useful economic life of the property to which they relate, subject to this not exceeding the useful economic life of the adaptations themselves. Where the costs are material, the entity should ensure that the net book value of the adaptations continues to give a true and fair view at the balance sheet date and make any necessary adjustments.
- 1.12 Where an entity opts to include the adaptation costs within the property interest, the entity will need to ensure that the valuer understands the general nature of the adaptations. It will not be appropriate, for example, for a valuer to value an embassy's additional stand-off land as surplus land: it is a necessary part of the property. Nor will it be appropriate for a valuer to value a newly built embassy building as a conventional office block.

Assessing replacement cost

- 1.13 Where DRC is being used to value specialised property (regardless of whether or not the property is historic or listed), it will rarely be appropriate to cost a modern reproduction of the asset (i.e. using an identical replacement or modified reconstruction approach). The value of the property should normally be based on the cost of a modern equivalent asset that has the same service potential as the existing asset and then adjusted to take account of obsolescence.

The Site value of a Specialised property

- 1.14 In selecting the site on which the modern equivalent asset would be situated, the valuer will consider whether the actual site remains appropriate (VIP section 7). For a central government entity, the choice of whether to value an alternative site will normally hinge on policy in respect of locational requirements of the service that is being provided.
- 1.15 So it could be that buildings that serve the community in which they are located – schools, hospitals, and other buildings used to deliver front-line services – might need to be on expensive inner-city sites or in town and city centres rather than on the outskirts. In these cases, the actual site is the site that should be valued.
- 1.16 Other buildings might not need to be located on the actual site. But alternative sites should only be used for valuation purposes when it is clear government policy that the actual sites would no longer be used and there is a clear and agreed plan to relocate (which might be medium term) to an identified site or general location. If there is no plan to relocate from a property being valued, then the actual site should be valued, even if similar properties on other sites are included in relocation plans. An entity that values its estate (in whole or in part) using alternative sites, should disclose the fact in its accounting policies note and give, in the notes to the accounts, the alternative use value, less costs of sale, of the existing site. The Management Commentary should also include a brief discussion of the relocation plans.
- 1.17 Where an entity could deliver its services from any site, and there is no stated government policy that the service has to be delivered from the actual site, but there is no clear and agreed plan to relocate, the entity should value the actual site and give the same disclosures as an entity that has used alternative sites in its valuation (for example, the alternative use value of the actual site in accordance with the Red Book..

Calculating the cost of the buildings and site improvements of a specialised property

The buildings and site improvements

- 1.18 Guidance on enhancements to existing assets is given in the section on valuation policy.

Historic buildings

- 1.19 It is rarely appropriate to value historic buildings on the basis of costing a modern reproduction by use of an identical replacements or modified reconstruction approach.
- 1.20 Where the historic nature of the property itself contributes to the service provided, it would be appropriate to reflect the cost of reproducing the existing asset in the cost of the modern equivalent (paragraph 8.7). The example of a parliament building is given. However, where it would be impossible for a modern reproduction to recreate the original's historic significance, entities should not cost such a reproduction (paragraph 8.8). (An example might be the Tower of London.)

- 1.21 Where an entity does cost on the basis of creating a modern reproduction using the identical replacement or modified reconstruction approach, it must be able to demonstrate that it is not valuing a mere facsimile of the existing asset and that the historic property itself is intrinsically part of the service potential. Before undertaking a valuation using a modern reproduction approach, an entity should discuss with the relevant authority (through the sponsoring department as necessary) whether such an approach is appropriate. Entities should start from the premise that it will not be.
- 1.22 Buildings of iconic status (which might or might not be historic or listed) that would be replaced by similarly iconic buildings, should be valued on the basis of a modern equivalent asset but including the costs of achieving that iconic status. That might mean, using the Royal Courts of Justice as an example, a modern court house that has either a façade in keeping with the surrounding buildings, or even a reproduction façade.
- 1.23 Further guidance on valuing heritage assets is being developed.

Sources of cost information

- 1.24 The VIP notes that the cost of a modern equivalent asset will reflect the cost that would be incurred if the works were commissioned on the date of valuation (paragraph 8.11). But it goes on to note (paragraph 8.12) that there are factors that may result in the cost of a notional replacement being different from that of creating the actual asset. These factors are:
- Site preparation. The VIP refers to works that may have been undertaken to prepare the actual site for occupation that would not need to be carried out on an assumed equivalent site. Entities should instruct the valuer to assume that the site being valued, whether on the basis of the actual or an alternative location, is level and serviced and ready for development. (Entities should refer above for guidance on the circumstances when a site in an alternative location can be valued.)
 - Phasing of work. The VIP notes that a large site may have been developed in phases and that the cost of a modern equivalent reflects a single phase development. Entities should instruct the valuer to assume a single phase development at the building cost at the date of valuation. Entities should also instruct the valuer to assume that the construction has happened 'instantly'. As a consequence, it follows that there will be no phasing of payments, and there will be no reflection of the cost of capital in the valuation.
 - Optimal working conditions. Abnormal working conditions at the actual site are ignored if an alternative site is being valued. If, for policy reasons (as outlined above), however, the actual site is being valued, entities should instruct the valuer to consider any additional costs that might necessarily be incurred in developing the site and make suitable adjustments (although these might already be factored into the market value of the site). For example, the access to the actual site might be such as to prevent the use of large plant and machinery in the construction of the replacement building, thereby increasing the contract costs because of the additional construction time required.
 - Additional costs arising from extending an existing property. These costs should be ignored, since the norm is that the valuation will be of a modern equivalent asset.
 - Contract variations. Additional construction costs because of design or specification changes should be ignored. The modern equivalent asset being valued will have the same service potential as the existing asset.
 - Planning changes. Entities should consider with the valuer whether planning consent would need to be obtained were the modern equivalent asset to be constructed on the actual site.

Assessing Depreciation

Functional obsolescence

- 1.25 Paragraphs 9.7 to 9.11 discuss functional obsolescence. One factor that might cause functional obsolescence is technological advances. This need not reflect only technological advances in, say, the delivery of healthcare. For example, the Ministry of Defence will need to consider whether the technological advances in military materiel mean that its hardened aircraft hangers would be replaced by different types of structures, and the effect this would have on the valuation of its existing hangers.

Economic obsolescence

- 1.26 References to the impact of changing demand for goods or services should be read to include, for non-revenue generating assets, references to future service potential.

Guidance on the valuation policy outlined in the FReM

- 2.1 Entities are reminded that their balance sheets must give a true and fair view of the value of the assets at the balance sheet date, but that, within the constraints imposed by the FReM, entities are free to adopt practices that are most appropriate to their circumstances.

Valuation of Property Assets

- 2.2 Entities have, within the confines of FRS 15, total discretion in how they determine the most appropriate valuation approach for their estates. When their valuers advise that DRC is the most appropriate valuation methodology, entities should refer to the guidance notes above when discussing the approach with their valuers.
- 2.3 Early and ongoing dialogue with the valuer is vital. Neither RICS guidance nor FRS 15 are tightly prescriptive regarding aspects of asset valuation methodology, particularly at the detail level of DRC. Within their confines, many subtle variations in approach or interpretation are possible and these can have a significant impact on the resulting figures produced. An instruction which simply asks for an asset valuation to be undertaken in accordance with RICS and FRS 15 will be insufficient to ensure that the entity receives a common result and consistency of approach over time, regardless of which valuer is used. Discussion between entity and valuer about the exact nature of the entity's bespoke requirements and how these can best be fulfilled is essential. Sufficient details about the exact approach employed must be captured for the benefit of future valuations, when it is likely that there will have been a change of valuer.
- 2.4 FRS 15 states that the objective of a revaluation is to reflect current values as at the balance sheet date. Full quinquennial valuations of properties, and an interim valuation every three years, will meet this objective. Interim valuations should only be carried out in the intervening years where it is likely that there has been a material change – and it is likely that the annual impairment review will give an indication of whether this is the case. Interim valuations are not the same as full valuations: paragraphs 47 and 49 of FRS 15 set out the differences: no need for a detailed inspection of the building or locality, unless the valuer feels it necessary; and no enquiries of the local planning and similar authorities nor of the entity or its solicitors. The valuer will seek confirmation that the property has not been altered in any way, and that there are no significant changes to legal rights or planning considerations. See below for more guidance on what to do when a property has been altered.

- 2.5 Entities with large estates might consider carrying out a rolling programme of revaluations following the guidance in paragraph 46 of FRS 15. In addition, entities with large estates comprising homogeneous properties (such as hospitals or prisons) might consider using an approach that bases the gross valuations on standard models. For example, it might be hypothesised that, ideally, an entity would use one of three building models or beacons to deliver a service, depending on location – inner city, town and rural. The valuer will be able to discuss and advise on how many beacons may in practice be required, having regard to the nature of the estate. An entity could derive a standard gross replacement cost for each building beacon, and then assess depreciation in line with the VIP (section 9; and also see above) for each of the individual property assets. Local land values would then be added to arrive at the DRC valuation.
- 2.6 Entities are permitted, but not required, to re-appraise the valuations of their properties using indices in the years between their quinquennial valuations. Interim valuations are not required where entities choose to use annual indexation. However, in the light of experience shared by the Working Group, entities should consider carefully the appropriateness of annual indexation in their particular circumstances and make a careful judgement as to whether annual indexation will result in a true and fair view of the value of their estates at the balance sheet date.

Valuation of Non-Property Assets

Depreciated historical cost basis as a proxy for current valuations

- 2.7 Entities may elect to adopt a depreciated historical cost basis as a proxy for current valuations for assets that have short useful economic lives or low values (or both). Examples where using depreciated historical cost as a proxy for current value might be appropriate are described below.
- 2.8 Motor vehicles: generally of relatively low value, and depreciated over a short useful economic life. The life should reflect established fleet management practice. Depreciation should be estimated in accordance with the expected reduction in vehicle values – which is not likely to be straight-line.
- 2.9 IT: the pace of technological change and reduction in values are generally reflected in a very short useful economic life. In some (more extreme) cases, IT might be expensed on purchase. Where IT is carried as an asset, depreciation should be estimated in accordance with the expected reduction in IT values – which might be straight-line.
- 2.10 Furniture (and fixtures and fittings generally): normally of relatively low value in relation to other assets. In some cases, office fixtures and fittings are expensed on purchase. Where they are capitalised, depreciation should be estimated in accordance with the expected deterioration – which is likely to be straight-line.

Non-property tangible fixed assets with longer useful lives should be carried at current value

- 2.11 Indices or other appropriate information sources should be used to determine the gross valuation of non-property assets where depreciated historical cost is not a suitable proxy for current value (unless there are specific requirements set out in the FReM for specific asset classes).

Enhancements

- 2.12 Enhancements to assets in the public sector invariably give rise to additional expenditure as a result of health and safety, security or operational requirements. Examples include the need to keep two lanes of a motorway operating, but at the same time ensuring the safety of the workers building a third lane; safeguarding prison's security while an additional wing is built within the curtilage; and the need to keep

a hospital open, but at the same time safeguarding the health and safety of patients and visitors while a new wing is build, and additional costs associated with linking new infrastructure to old.

- 2.13 When the enhancement is brought into use, a new asset comes into existence. On the first valuation of this new asset the valuer will value it as a single asset, and will not take account of the additional costs arising from the above requirements. (This expenditure could be described as the immediate revenue consequence of a capital project.) The difference between the construction cost and the initial valuation of the new asset will be written off to the operating cost statement.

IMPAIRMENTS: DEFINITIONS

Loss or Damage resulting from normal business operations

All losses of, and damage to, tangible fixed assets that reduce the recoverable amount to below the book value other than those caused by a catastrophe (see below). Normal business operations covers all loss and damage to assets that result from management and staff action (or inaction), and the actions of third parties. This category includes theft.

Loss as the result of a catastrophe

Damage to tangible fixed assets as a result of a catastrophe. The System of National Accounts (SNA93) which forms the basis of recording transactions in the National Accounts defines a catastrophe as: 'such events as will be generally easy to identify. They include major earthquakes, volcanic eruptions, tidal waves, exceptionally severe hurricanes, droughts and other natural disasters; acts of war, riots and other political events; and technological accidents such as major toxic spills or release of radioactive particles into the air'.

Such events are very rare in global terms and exceptionally rare in the UK. Where a department believes an impairment should be scored as a Catastrophic Loss rather than 'Loss or Damage resulting from normal business operations' it should first contact the relevant authority.

For the avoidance of doubt, the following are not catastrophes within the meaning of this definition. Prison or street riots; loss or damage due, for example, to an ingress of water that could have been avoided by better maintenance; and relocation to a site where flooding is likely. These are all examples of losses resulting from management action or inaction.

Abandonment of assets in the course of construction

The impairment of assets in the course of construction as a result of a management decision to abandon the construction process, i.e. management decides that it no longer requires the facility under construction and the construction costs to date are completely written off or substantially written off to reflect reduced utility. This category includes the abandonment of software assets in the course of construction.

Unforeseen Obsolescence

All assets are subject to obsolescence. However, the rate of obsolescence tends to be category specific: e.g. IT assets suffer a faster rate of obsolescence than do buildings. Departments will take account of foreseeable obsolescence when establishing asset lives. Unforeseen obsolescence will generally only occur either as the result of the introduction of a completely new technology or a change in legislation rendering the asset illegal. As such events are exceptionally rare, the relevant authority should be contacted prior to the use of this category.

Over Specification of Assets (Gold Plating)

Gold plating is the unnecessary over-specification of assets at the point at which the asset is first constructed or purchased. This category should be used where the gold plating of assets leads to an impairment either

because the asset is valued at its utility value to the business, or because the gold plating cannot be reflected in the recoverable amount.

Care should be taken not to impair assets as being gold plated where they are of a high specification by necessity. For example, the high specification of embassies is in part a result of security and other factors relating to location and the needs of a representational building. The higher specification due to justified security and operational considerations should not lead to an impairment down to the value of ordinary office accommodation. The key is that the higher specification must be justifiable: if it is not an impairment should be taken.

Other Impairments.

This category includes impairments that cannot be scored to another impairment with the exception of downward revaluations (see below) category and include:

- **Write Down to Depreciated Replacement Cost** – This occurs where specialised building assets or enhancements (e.g. the construction of a new wing) to such assets are written down to depreciated replacement cost (DRC) following the first professional valuation.
- **Write Downs of Development Land** – This occurs where land is purchased for some form of social development. The cost of the land and any clean up cost can be greater than the disposal value resulting in an impairment.
- **Changes in Use** – This usually occurs where specialised assets no longer required for their original purpose are put to a non specialised use (e.g. a hardened aircraft hangar used as a store). However, impairment can result from the change of use of any asset including non-specialised assets.
- **Disposals** – Impairments can occur where assets are moved from 'in use' to 'available for sale'.
- **Uncompensated Seizures** – The seizure of assets by governments or institutional units, other than for the settlement of fines or taxes, for which full compensation is not provided.

Other Impairments not detailed

Please contact the relevant authority for advice.

Revaluations

Downward revaluations result in an impairment where an asset is revalued below its historical cost carrying amount.