

6 July 2009

**GOVERNMENT FINANCIAL REPORTING
MANUAL (FReM) EXPOSURE DRAFT No:**

(09)4

EXPOSURE DRAFT OF PROPOSED

AMENDMENTS TO THE FReM

**Re-measurement of in use non-specialised
property under IAS 16, Property, Plant and
Equipment**

Comments to be received by 25 September 2009



HM TREASURY

ASSURANCE AND FINANCIAL REPORTING POLICY TEAM HM TREASURY

This exposure draft of proposed amendments to the Government Financial Reporting Manual (FReM) is published by HM Treasury for comment only. The proposals may be modified in the light of comments received in this consultation process before being presented to the Financial Reporting Advisory Board for its approval. Final proposals approved by the Financial Reporting Advisory Board will be published as amendments to the FReM from the proposed effective date.

Comments on this exposure draft should be submitted in writing so as to be received by **25 September 2009**. Respondents are asked to send their comments electronically to FReM.consultation@hm-treasury.gov.uk.

All responses will be published on the FReM website unless the respondent requests confidentiality.



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Introduction

Assurance and Financial Reporting Policy team, HM Treasury, has published this exposure draft of proposed amendments to the Government Financial Reporting Manual (FReM) as part of its ongoing work in ensuring that the Manual reflects the latest developments in government financial reporting.

Structure of exposure draft

The exposure draft includes a section for each FReM chapter for which an amendment is proposed. Each section includes:

- (a) An explanation of why the amendment is proposed.
- (b) When necessary, any specific additional question unique to that proposed amendment;
- (c) The paragraphs of the FReM chapter that are affected by the proposed amendment;
- (d) The proposed effective date of each proposed amendment.

Invitation to comment

HM Treasury invites comments on the proposed amendments. It would particularly welcome answers to the questions set out below. Comments are most helpful if they:

- (a) Answer the question as stated;
- (b) Indicate the specific paragraph or paragraphs to which they relate;
- (c) Contain a clear rationale; and
- (d) Describe any alternative HM Treasury should consider.

HM Treasury will consider all comments received in writing by 25 September 2009. In considering the comments, HM Treasury will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

Re-measurement of in use non-specialised property under IAS 16, <i>Property, Plant and Equipment</i>	
Why the amendment is proposed	There is at least some doubt that the intention of IAS 16 is that in use non specialised property assets should be measured on an exit basis. Even if it is the case that an exit value is required such a valuation would seem to be of limited use to the central government sector. The proposed amendment seeks to provide greater clarity in the measurement of non specialised property.
Paragraph affected by the amendment	6.2.5
Proposed date	The current year, 2009/10

Background

IAS 16 Property, Plant and Equipment provides no clear guidance as to the valuation basis for in use non-specialised property assets which is creating uncertainty for departments and their valuers.

Summary

This Exposure Draft proposes that central government retains value in use as the basis for valuing in use non-specialised property and that this basis of valuation is later reviewed in light of the requirements of the IASB's Fair Value Measurement standard, which is due to be issued in 2010.

General questions (applicable to all proposed amendments)

Question 1

Do you agree with HM Treasury's proposal to amend the FReM as described in the exposure draft? If not, why not, and what alternative do you propose?

Question 2

Do you agree with the proposed effective date, and any proposed transition provisions, for the issue as described in the exposure draft? If not, why not, and what alternative do you propose?

FReM chapters addressed

The following table shows the topics addressed by these proposed amendments.

FReM Chapter	Subject of amendment
Chapter 6, Tangible Non-Current Assets	6.2.6 (d) Value in use

Proposed amendment to Government Financial Reporting Manual Chapter 6 *Tangible Non-Current Assets*

Introduction

1. An amendment to Chapter 6 Tangible Non-Current Assets of the Government Financial Reporting Manual is proposed.
2. IAS 16 Property, Plant and Equipment provides only a limited explanation as to how land and building assets are to be revalued. IAS 16 is unclear as to whether in use non-specialised property assets should be valued on an existing use basis or at an exit value. This is creating uncertainty for departments and their valuers.

Why the amendment is proposed

FRS 15 and IAS 16 Guidance

3. FRS 15 Tangible Fixed Assets is clear as to the re-measurement bases for property assets. Specialised properties are valued at depreciated replacement cost (DRC). In use non-specialised properties are valued at existing use and surplus properties at open market value.
4. IAS 16 provides the following text in respect of re-measuring property assets,
 - **Paragraph 32.** The fair value of land and buildings is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers. The fair value of items of plant and equipment is usually their market value determined by appraisal.
 - **Paragraph 33.** If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach.
5. IAS 16 is clear that the measurement basis for specialised property where no market based evidence is available, is DRC, i.e. the same as that under FRS 15. The standard is less clear on the measurement basis for in-use non-specialised property. Paragraph 32 of IAS 16 can validly be interpreted as either being the market value of the asset in its existing use or its exit value.

Latest Guidance from the IASB on Fair Value Measurement

6. The IASB is currently reviewing its fair value guidance as, in the IASB's own words (as contained in the project overview on the IASB's website): *IFRSs require some assets, liabilities and equity instruments to be measured at fair value. However, guidance on measuring fair value has been added to IFRSs piecemeal over many years as the Board or its predecessor decided that fair value was the appropriate measurement basis in a particular situation. As a result, guidance on*

measuring fair value is dispersed across many IFRSs and it is not always consistent. Furthermore, the current guidance is incomplete, in that it provides neither a clear measurement objective nor a robust measurement framework. The Board believes that this adds unnecessary complexity to IFRSs and contributes to diversity in practice.

7. In addition paragraph 25 of the Basis of Conclusion to IAS 16 says: *The Board is taking part in research activities with national standard-setters on revaluations of property, plant and equipment. This research is intended to promote international convergence of standards. One of the most important issues is identifying the preferred measurement attribute for revaluations. This research could lead to proposals to amend IAS 16.*

8. The IASB has now issued exposure draft ED/2009/5, *Fair Value Measurement* for comment by 28 September 2009. This exposure draft indicates that assets will be valued at their highest and best use, which implies an exit value. However, the exposure draft also indicates that for certain assets existing use principles will continue to apply. The IASB intend to issue their Fair Value Measurement standard mid 2010 providing much needed clarity on the measurement basis of property and other assets.

Proposed Approach for Central Government

9. There is at least some doubt that the intention of IAS 16 is that for non-specialised property assets to be measured on an exit basis. Even if the intention is to value at an exit value the information would be of questionable benefit in the context of public sector accounts as decision criteria are concerned with service delivery and the need to site certain services within a specific location rather than the potential disposal proceeds. For certain assets existing use better reflects the needs of central government, i.e. the service potential inherent in the asset and not its theoretical market value.

10. If IAS 16 is interpreted as requiring a exit valuation there is risk that non-specialised properties will need to be valued using three differing bases over a relatively short period of time, (i.e. on an existing use value under FRS 15 for 2008/09, an exit value basis under IAS 16 for 2009/10 and potentially, an alternative basis under the IASB's new fair value standard) and that for certain of these measurement bases the information provided in financial statements will not be relevant to the needs of users.

11. The Treasury is committed to minimising the burdens of first time adoption of IFRS and to continually review the applicability of the standards to central government, to ensure adaptations of the standards are necessary and relevant. The Treasury therefore proposes that the practice on valuing non-specialised property on an existing use basis is retained in the 2009-10 and 2010-11 versions of the FReM as an adaptation. The Treasury will review this basis of valuation once the IASB has issued its Fair Value Measurement standard.

Proposed amendment

6.2.5 - New adaptation - For 'in use' non-specialised property assets fair value should be interpreted as market value for existing use. In the RICS Red Book this is defined as 'market value on the assumption that property is sold as part of the continuing enterprise in occupation.

Effective date of amendment

The effective date for the proposed amendment is 1 April 2009.