Financial Reporting for Heritage in the Public Sector

ICAEW welcomes the opportunity to comment on the *Financial Reporting for Heritage in the Public Sector* consultation paper published by the International Public Sector Accounting Standards Board (IPSASB) in April 2017, a copy of which is available from this link.

This response of 29 September 2017 has been prepared on behalf of ICAEW by its Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. Comments on public sector financial reporting are prepared with the assistance of the Faculty's Public Sector Financial Reporting Development Committee. The Faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA UK

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City
icaew.com

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 147,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

For more information, please contact representations@icaew.com

icaew.com

MAJOR POINTS

Support for the consultation paper

1. We welcome the opportunity to contribute to this consultation on financial reporting for heritage in the public sector. We support IPSASB's broader strategy of focusing on public sector-specific accounting standards since that is where there is a sizable gap in current accounting literature. It is in the public interest for more governments to adopt high quality internationally-recognised accounting standards and no doubt the attractiveness of adopting IPSASs will increase with a wider coverage of relevant accounting issues. Nonetheless, we suggest IPSASB keeps an open mind as to whether current standards could be extended to accommodate issues around heritage assets, as opposed to producing a separate standard on this topic. If the bulk of heritage assets could be accounted for using existing standards, we should question the need for a specific heritage standard.

2. Accounting standards for heritage assets are not new in the UK. The Financial Reporting Council consulted on this topic in 2006, 2007 and 2008 during the development of FRS 30 *Heritage Assets.* ICAEW's Financial Reporting Faculty was involved in this consultation process and we are delighted to share with you our previous experience in debating the difficult conceptual and practical financial reporting issues that arise in relation to heritage assets. We have rehearsed below as a matter of record some of the issues we identified in those previous discussions before answering the question posed in the consultation paper.

Some conceptual issues

3. The inclusion of heritage assets on the balance sheet is problematic when monetary amounts do not constitute an appropriate measure of those assets. The real value of heritage assets is often best appreciated in terms of the knowledge and culture that they will impart in future periods, and such 'units of public benefit' do not fit easily with the monetary framework of the balance sheet.

4. In the majority of cases, heritage assets are not 'economic assets' in the normal sense, particularly where any value placed on them would be more than offset by the cost to the entity of meeting its obligations to maintain the assets.

5. There may be implications for decisions over recognition, especially for those entities holding heritage assets with objectives not related to the restoration and maintenance of heritage items or the furthering of knowledge and culture via those items. Examples of entities that could hold heritage items yet have a different objective include local authorities, universities and national libraries.

Some practical considerations

6. In terms of practical considerations, in our experience the most important issue for many reporting entities is the likelihood that the costs involved in valuing many heritage assets will be far greater than the benefit to users. The cost/benefit argument is commonly made during discussions of this subject and whilst the costs are easily understood, the benefits may not be. We recommend that IPSASB provide guidance on the costs and particularly the benefits of recognising heritage items on the balance sheet to help preparers in their evaluation.

7. Valuation techniques are not well developed for many types of heritage items. There are limits to what can actually be valued and disclosure requirements will play an important role in providing users with the relevant and complete information needed to hold entities to account and to understand the nature of heritage asset portfolios.

8. The current situation in the UK is that assets are recognised on the balance sheet where they meet the recognition criteria and their value can be measured at a reasonable cost compared

to the benefits. Other items are off-balance sheet, but enhanced disclosures are designed to counterbalance this limitation.

9. In light of the practical considerations outlined above, we believe that IPSASB should consider more fully the identity of the key users of the financial statements that include heritage assets, and the information that they seek in relation to heritage assets. It might also be useful to reflect on the accounting and reporting approach taken by the UK central government. That approach to financial reporting is very pragmatic, in summary allowing for both cost and valuation measurement bases, the use of the most practical valuation techniques (external and internal) and non-prescribed minimum period between valuations. If costs of obtaining suitable valuations outweigh the benefits of doing so, non-recognition on the balance sheet is permitted but disclosures are still required.

RESPONSES TO IPSASB QUESTIONS

Question 1

Specific Matters for Comment

Do you agree that the IPSASB has captured all of the characteristics of heritage items and the potential consequences for financial reporting in paragraphs 1.7 and 1.8?

If not, please give reasons and identify any additional characteristics that you consider relevant.

10. We believe that the most important characteristics of heritage items and their consequences for financial reporting have been adequately captured. However, we suggest that the Board considers the following additional points:

- The value of heritage assets may increase over time even if their physical condition worsens.
- Heritage assets cannot always have monetary amounts assigned to them. The true value of many heritage assets is the knowledge and culture that they impart. For this reason, the value of heritage items is unlikely to be fully reflected in a monetary value derived from a market mechanism or price.

11. The practical implications on financial reporting of additional characteristics reflecting the above points would be twofold. Firstly, deterioration in the physical condition of an asset would not be a sufficient indicator of impairment. Additional factors would need to be taken into account, such as rarity. Secondly, many heritage assets are not ‘economic assets’ in the normal sense, particularly where any value placed on them would be more than offset by the cost to the entity of meeting its obligations under trusts or legislation to maintain the assets. Heritage assets often do not even embody service potential in any measurable form. This may result in only a portion of a nation’s heritage assets being on-balance sheet, with a significant portion being off balance sheet.

Question 2

Preliminary View

For the purposes of this CP, the following description reflects the special characteristics of heritage items and distinguishes them from other phenomena for the purposes of financial reporting:

Heritage items are items that are intended to be held indefinitely and preserved for the benefit of present and future generations because of their rarity and/or significance in relation, but not limited, to their archeological, architectural, agricultural, artistic, cultural, environmental, historical, natural, scientific or technological features.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

12. We broadly agree with the above proposed definition but question the need to include the assumption that items are intended to be held indefinitely. This may lead preparers to conclude that heritage items have an infinite life, which would then have consequences for depreciation. We do not believe that that was IPSASB's intention. We recommend that the Board simply removes 'indefinitely' from the PV above. To state that items are to be preserved for present and future generations already implies a very long time horizon.

13. A future IPSAS on heritage items should illustrate the link between an entity's objectives, the reasons for holding the asset and the relevant classification of the asset. We believe that, depending on an entity's objectives, in particular whether or not the entity has preservation objectives, and the reason for holding the asset, the same asset could either be classified as a heritage asset or as an investment. For example, a local authority that purchases a Monet painting could reasonably classify it as either a heritage asset or an investment depending on the purpose of why this painting was purchased. Conversely, a human rights charity, for example, could not in all likelihood hold something that would be classified as a heritage asset, since such an asset would never be held in line with the description of the PV above.

14. Heritage assets used for operating activities such as buildings will often be used by entities which do not have any heritage-related objectives. The standard will need to make it clear when these should be treated as heritage assets, property, plant and equipment or investments/investment properties.

Question 3

Preliminary View

For the purposes of this CP, natural heritage covers areas and features, but excludes living plants and organisms that occupy or visit those areas and features.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

15. We agree with the PV above but IPSASB may wish to look again at the agriculture standard, which may include within its scope living plants and organisms that could also meet the definition of heritage assets, to consider whether such assets are or should be within scope.

Question 4

Preliminary View

The special characteristics of heritage items do not prevent them from being considered as assets for the purposes of financial reporting.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

16. We agree with the PV. In many cases, the real value of heritage items is the knowledge and culture that they will impart, and such 'units of public benefit' do not fit the monetary framework of the balance sheet. Nevertheless, we believe that heritage items should, in most cases, be accounted for as assets, as they would meet the definition set in the conceptual framework. We agree with the CP (paragraph 3.2) that heritage items will be held more for their service potential than for economic benefits, although in many cases economic benefits may be derived from them, for example by charging the public for access.

17. Service potential is the capacity to provide services that contribute to achieving the entity's objectives. We believe that a future standard on heritage assets should clearly spell out the accounting treatment for those assets that are used to support an entity's objectives which are not heritage-related, as described in paragraph 3.4 of the CP. Using service potential as a key determinant of a resource needs to be carefully considered when the service potential of the heritage asset appears not to support an entity's primary objective.

Question 5

Specific Matters for Comment

Do you support initially recognizing heritage assets at a nominal cost of one currency unit where historical cost is zero, such as when an asset was fully depreciated before being categorized as a heritage asset and transferred to the entity, or an entity obtains a natural heritage asset without consideration?

If so, please provide your reasons.

18. We strongly disagree with the initial recognition of heritage assets at a nominal cost of one currency unit, regardless of the circumstances. There is no conceptual basis for doing so and would, in our opinion, not serve any purpose and could, indeed, be misleading. The same recognition criteria should apply as for other fully depreciated assets and assets obtained without consideration.

19. In the case of many heritage assets, the demonstration of stewardship and accountability is often of greater importance than ascribing a monetary value. Where it is not possible to obtain a monetary valuation, such stewardship can often be achieved by making relevant disclosures. Attaching a notional value to heritage assets will not make a difference to actual balance sheet values: they will be immaterial and will not provide information to users to enable them to hold the entity to account and to assess their stewardship of the assets. In addition, we do not see a problem with capitalising improvements to heritage assets just because the original asset could not be recognised on balance sheet because valuation was too difficult or costly.

Question 6

Preliminary View

Heritage assets should be recognized in the statement of financial position if they meet the recognition criteria in the Conceptual Framework.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

20. We agree with the PV above that, if the recognition criteria are met, heritage assets should be recognised in the statement of financial position.

21. For many heritage assets, valuations can be obtained and will be sought for non-accounting reasons, such as insurance, thus adding no additional costs for financial reporting purposes. Judgement will need to be exercised in comparing the costs in relation to benefits. There is a risk that an entity's default starting position is that costs exceed benefits and that therefore the assets would remain off balance sheet. We strongly recommend that IPSASB provide some guidance on what benefits are likely to be achieved to encourage balance sheet recognition wherever appropriate and possible.

22. Carrying out valuations using an external valuer could potentially be very expensive, and even if it is not, it could be argued that for a charity, for example, any resource spent on a valuation that may not be useful to most readers of their accounts is a poor use of those resources. We therefore also recommend that IPSASB consider allowing entities to carry out internal valuations, with management permitted to make reasonable estimations.

Question 7

Specific Matters for Comment

Are there heritage-related situations (or factors) in which heritage assets should not initially be recognized and/or measured because:

(a) It is not possible to assign a relevant and verifiable monetary value; or

(b) The cost-benefit constraint applies and the costs of doing so would not justify the benefits?

If yes, please describe those heritage-related situations (or factors) and why heritage assets should not be recognized in these situations.

23. Not being able to assign a relevant and verifiable monetary value and cost-benefit constraints are the only reasons why heritage assets may not be recognised on the balance sheet. There will be a number of factors and heritage-related situations that may prevent their balance sheet recognition in these situations such as:

- Volume of artefacts to be valued could lead to costs exceeding benefits;
- Rarity and uniqueness of an item could render a valuation impossible, for example if only one example exists such as the Rosetta stone;
- Natural heritage items with no alternative use, such as the Grand Canyon, would be difficult to value.

24. Inalienability could mean that a valuation lacks meaning, as the resultant figure could never be realised in the marketplace, but we believe that this should not automatically prevent a valuation being used for financial reporting purposes.

Question 8

Preliminary View

In many cases it will be possible to assign a monetary value to heritage assets. Appropriate measurement bases are historical cost, market value and replacement cost.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

25. We agree with the PV above.

26. It may be helpful to split heritage assets between operational and non-operational assets. Operational heritage assets are those that, in addition to being held for their characteristics as part of the country's heritage, are also used by the reporting entity for other activities or to provide other services. The most common example is buildings. Non-operational heritage assets are those that are intended to be preserved in trust for future generations because of their cultural, environmental or historical associations.

27. Operational assets will be somewhat easier to assign a monetary value to and we agree that appropriate measurement bases are historical cost, market value and replacement cost. However, due to the restrictions often placed on future sale of such items, there may be no 'market'. Furthermore, replacing the asset like for like is, in most cases, not achievable due to lack of labour skill and suitable building materials that were used historically. Guidance, including a decision tree, would be needed to provide preparers with practical examples of how to apply the measurement bases in such circumstances.

28. In the UK's government accounting guidance (the FReM), non-operational assets are either measured at cost or fair value. For assets already capitalised or recently purchased, information on their cost or market value will be available. For assets where this information is not available, and where costs outweigh the benefits, the assets are not recognised on the balance sheet but disclosures such as why they are off-balance sheet, their significance and nature are nevertheless required. Furthermore, the guidance states that valuations may be made by any method that is appropriate and relevant (ie do not have to be professional external valuations). There are no minimum prescribed periods between valuations. The guidance in the FReM is deliberately quite flexible to encourage entities to value their assets and put them on their balance sheets. We support this approach as it is proportionate and pragmatic, while following the spirit of the conceptual framework. In particular, cost may be the default measurement option in many cases as obtaining up-to-date valuations would be too costly, but using historical cost at least allows the asset to be put on balance sheet.

Question 9

Specific Matters for Comment

What additional guidance should the IPSASB provide through its Public Sector Measurement Project to enable these measurement bases to be applied to heritage assets?

29. We would like to see additional guidance within the Public Sector Measurement Project on the following areas:

- A decision tree to guide preparers through recognition and measurement principles;
- More guidance on determining market value when there is no market or an inactive market;
- Examples of where a monetary value cannot be established and estimation techniques would not provide relevant or faithfully representative outcomes;

- How to assess impairment for assets that are not necessarily impacted by physical deterioration.
- The benefits that should be considered when weighing up cost-benefit implications of obtaining a value for financial reporting purposes.

Question 10

Preliminary View

Subsequent measurement of heritage assets:

(a) Will need to address changes in heritage asset values that arise from subsequent expenditure, depreciation or amortization, impairment and revaluation.

(b) Can be approached in broadly the same way as subsequent measurement for other, non-heritage assets.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

30. We agree in principle with the PV above.

Question 11

Specific Matters for Comment

Are there any types of heritage assets or heritage-related factors that raise special issues for the subsequent measurement of heritage assets?

If so, please identify those types and/or factors, and describe the special issues raised and indicate what guidance IPSASB should provide to address them.

31. Most heritage assets will have long or even indefinite useful economic lives. IPSAS 17 *Property, Plant and Equipment* currently does not offer any guidance on subsequent measurement for tangible assets with an indefinite useful life. We would like to see some guidance to help preparers estimate the useful economic life of heritage assets. Otherwise there is a risk that each jurisdiction will apply different principles and arrive at different outcomes which impact on depreciation and impairment testing.

32. Annual expenditure on heritage assets for their general maintenance may be substantial. Currently, IPSAS 17.23 states that day-to-day servicing costs, consisting mainly of labour and consumables, are to be recognised in surplus or deficit under a suitable heading such as repairs and maintenance. These could be substantial for heritage items and more detailed guidance as to when these can be capitalised is required. There is a particular concern about subsequent expenditure for off balance sheet items when the accounting policy is to fair value the assets since the subsequent expenditure will not be equivalent to the fair value of the asset. In our view it should be possible to capitalise such expenditure, but some guidance ought to be given on how this should be presented and when depreciation is required. An example may be a lift placed in a historical building, which may need to be replaced every 20 to 30 years.

Question 12

Preliminary View

The special characteristics of heritage items, including an intention to preserve them for present and future generations, do not, of themselves, result in a present obligation such that an entity has little or no realistic alternative to avoid an outflow of resources. The entity should not therefore recognize a liability.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

33. We agree with the PV that the special characteristics of heritage items do not in themselves give rise to a present obligation that the entity has little or no realistic alternative to avoid. This is in line with the conceptual framework.

Question 13

Preliminary View—Chapter 7

Information about heritage should be presented in line with existing IPSASB pronouncements.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons and describe what further guidance should be provided to address these.

34. We agree that many disclosures for heritage assets will be in line with other IPSASB standards. In the UK, however, enhanced disclosures for heritage assets play an important role where non-capitalisation of those assets is appropriate as the costs of doing so would outweigh the benefits. We believe, therefore, that some additional guidance may be required to enhance the stewardship information given. For example, guidance could be given on how to make disclosures about collections of assets where some are on balance sheet and some are off balance sheet, about location and condition of heritage assets, particularly when these are not on display, and so on.