THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

7 October 2008

Our ref: ICAEW Rep 116/08

Your ref:

Alan O'Connor
The Accounting Standards Board
5th Floor, Aldwych House
71-91 Aldwych
LONDON
WC2B 4HN

Email: fred40@frc-asb.org.uk

Dear Mr O'Connor

FINANCIAL REPORTING EXPOSURE DRAFT 42: HERITAGE ASSETS

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to respond to your request for comments on Financial Reporting Exposure Draft 42, *Heritage Assets.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Caron Bradshaw
Secretary to Charities Sub-Committee
Technical Strategy
T +44 (0)20 7920 8579
F +44 (0)20 7638 6009
E caron.bradshaw@icaew.com

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 116/08

FINANCIAL REPORTING EXPOSURE DRAFT 42: HERITAGE ASSETS

Memorandum of comment submitted in October 2008 by The Institute of Chartered Accountants in England and Wales, in response to the ASB's *Financial Reporting Exposure Draft 42: Heritage Assets*, published in June 2008.

Contents	**Paragraph**		

Chartered Accountants' Hall
PO Box 433 Moorgate Place London EC2P 2BJ
www.icaew.com
T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX DX 877 London/City

INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on Financial Reporting Exposure Draft 42, *Heritage Assets* (FRED42) published by the Accounting Standards Board (ASB).

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

4. The ICAEW Charities Sub-Committee is responsible for co-coordinating the technical considerations of the charity sector with respect to Chartered Accountants working within or for charities. Its membership represents the interests of practitioners, their clients and Chartered Accountants employed in financial roles within charities.

ACCOUNTING FOR HERITAGE ASSETS

5. The ASB states that, having considered a number of alternatives, it is not convinced that there is a better accounting solution for heritage assets than the current FRS15-based approach. We disagree.

6. As we stated in our response to the ASB Discussion Paper *'Heritage Assets: Can accounting do better*?' published in January 2006 (the 2006 Discussion Paper), we have serious reservations about the accounting framework on which ASB has based its consideration. We do not consider that the discussion of assets in the 2007 *Statement of Principles for Financial Reporting – Interpretation for public benefit entities* (the 2007 Interpretation) provides an adequate justification for the application of FRS15 to heritage assets. Few, if any, heritage assets are 'economic assets' in the normal sense and in the majority of cases they do not even embody service potential in any measurable form. The question of assets held by an entity only because it is obliged to do so under the provisions of a trust or legislation is not even considered in the 2007 Interpretation. Further consideration must be given to the question of what heritage assets really are, in order to establish the appropriate accounting treatment of such items.

7. We are very disappointed that no progress has been made over the 2½ years since the 2006 Discussion Paper was published. The proposed reporting requirements will perpetuate the partial capitalisation of heritage assets, based on practical considerations rather than accounting principles. We would deplore such a development, and urge the ASB not to issue a Financial Reporting Standard based on FRED42. The following general points, and our answers to the questions asked in

the FRED, are made as a contribution to the debate, which we believe should continue until the issues have been properly thought through and resolved.

GENERAL POINTS

Definition of 'heritage asset' and scope of proposed requirements

8. We note that the definition of a heritage asset is basically unchanged as "an asset with historic, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture". We support two changes that have been made, firstly that the purpose for which the asset is held does not now have to be central to the entity's Objects, and secondly that the definition of a "collection" has been taken out, as the recommendation for valuation on a collection by collection basis has been dropped.

9. So far as scope is concerned, we note that the proposed Standard now refers to "heritage assets", rather than "entities that hold heritage assets", which should make the requirements clearer. However, the explanatory material on heritage assets that are not held solely as such but are used for administrative or revenue-earning purposes is inconsistent with the definition and therefore unhelpful. Paragraph 4 refers to "assets of **historical** interest … held by the entity because of their **historical** characteristics", with no reference to all the other qualities (artistic, scientific, etc.) that define an asset as 'heritage'. We recommend that the explanatory material be expanded to remove this inconsistency.

Increased disclosures

10. We support the stated objective of achieving enhanced disclosures about heritage assets, irrespective of whether or not they are included on the entity's balance sheet. The requirement for financial statements to be more informative reflects the fiduciary duty of entities holding heritage assets to identify, account for and safeguard <u>all</u> such assets.

11. We are pleased that FRED42 now allows the reporting of acquisitions and disposals of heritage assets in the statement of financial activities and/or income and expenditure statement, which is in line with the recommendation made in our response to FRED 40.

12. However, we still question the usefulness of requiring a summary of transactions for the current period with comparative figures for the 4 preceding periods, as explained more fully in our paragraph 13 below. We question the utility of such an extended history to users of the entity's accounts.

Donations of heritage assets

13. Paragraph 23 requires the receipt of donations of heritage assets to be reported in the profit and loss account at current value at the date they are received. The profit will almost certainly be unrealised because the nature of heritage assets is that they would not meet the definition of qualifying consideration (i.e. readily convertible to cash etc). Therefore, paragraph 12 of Schedule 4 Companies Act 1985 (and its equivalent in the 2006 Accounting Regulations) would prohibit the inclusion of the profit in the profit and loss account of companies that hold heritage assets.

14. The ASB should therefore clarify whether they expect companies to use the true and fair override or alternatively report the gains in the Statement of Total Recognised Gains and Losses when they are unrealised. Although FRS 15 includes an existing requirement about the receipt of gifts and donations by charities, these requirements refer only to inclusion in the balance sheet and do not mention the treatment in any performance statement.

ANSWERS TO SPECIFIC QUESTIONS

1. This exposure draft proposes enhanced disclosures for heritage assets. Do you agree with the proposed disclosures and are there any additional disclosures that you consider would provide useful information?

15. Yes, the proposed disclosures appear generally to be appropriate. However, we consider the requirement for transaction summary disclosures covering five accounting periods as suggested in paragraph 12 to be unnecessary. As we have argued on our responses to previous consultations, there should not be a requirement for more than one year's comparative figures. Reporting on acquisitions and disposals in further periods should be optional, depending on the entity's assessment of the usefulness of the information to its key stakeholders. We suggest that it would be more valuable for the entity to disclose additional information about the annual costs it incurs in maintaining, administering and safeguarding its heritage assets.

2. The objective of the proposals is to improve the financial reporting of heritage assets. Do you agree that it is difficult to improve upon the current FRS 15 based accounting and that heritage assets should be reported in the balance sheet where information on cost or valuation is available?

16. No, we consider that FRS 15 can be improved upon by a specific standard. Because the consideration of heritage assets in the 2007 *Statement of Principles for Financial Reporting – Interpretation for public benefit entities* (the 2007 Interpretation) is at best superficial, there is no adequate conceptual rationale for the application of FRS15 to heritage assets. As we have already stated, in the majority of cases heritage assets are not 'economic assets' in the normal sense. Indeed, entities such as the National Trust have argued that any value placed on the properties that they hold would be more than offset by their costs in meeting their obligations under trusts or legislation to maintain the assets.

17. The 2007 Interpretation appears to be based on consideration of public service entities, where economic use and service potential are certainly relevant. Entities holding heritage assets, on the other hand, may do so only because they are obliged to do so under the provisions of a trust or legislation. Until the implementation of the Charities Act 2006, charities did not even have to demonstrate the 'public benefit' of their activities. The particular features of heritage assets mean that three of the four stated objectives of FRS15 cannot easily be met: it is very difficult to ensure that consistent principles are applied to the initial measurement of the assets, and equally difficult to ensure consistent application of the principles of revaluing the assets. Depreciation or impairment, if not irrelevant, is likely to be very hard to quantify. The only clearly relevant objective of FRS15 is to ensure good disclosure of the assets themselves and related transactions – though even here we question the relevance of "financial position and performance" to most entities holding heritage assets.

3. The exposure draft notes that impairment reviews will often not be relevant for heritage assets. Do you agree that impairment reviews should be required only where there is evidence that the value of an asset may have declined due to physical deterioration or damage? If not, in what circumstances should an impairment review be required?

18. We consider that, because of the particular nature of heritage assets, impairment reviews for the normal reasons of physical deterioration or damage may only be appropriate in rare circumstances. There are other circumstances where an impairment review should be undertaken. For example, if the reported valuation of a heritage asset includes a 'rarity' loading, the discovery of other or better examples might cause its value to be diminished. Similarly, if the asset were found not to be genuine (for example, in the light of new research/knowledge), its value would be impaired or even reduced to nothing.

19. The issue that needs to be addressed is that, as the proposed definition on paragraph 2 itself states, a heritage asset is an asset that is held and maintained principally because of its contribution to knowledge and culture. Assets that are used by the entity in the course of its activities may not qualify as heritage assets. Therefore the question of damage or physical deterioration is often irrelevant to the 'value' of the item, much though damage of any kind might be regretted. 'Impairment' in relation to heritage assets involves considerations of their ability to generate social and cultural good, rather than measurable economic benefits.

4. As explained … the Board believes that the costs of implementing the proposals should not be disproportionate. Do you agree? If not, why not? It would be helpful if any significant costs that would arise on implementation of the proposals, (including any not identified [by ASB]) could be identified and quantified.

20. We agree that as drafted the proposals should not be costly to implement, because they do not make any significant changes to current financial reporting requirements. Under the proposals, heritage assets are required to be reported on balance sheet where information on cost or valuation is available, so that if the information is not available, and would be difficult/expensive to obtain, the assets need not be capitalised.

21. The main advance on previous proposals and current practice may be in the tighter definition of heritage assets, which seeks to restrict the application of the requirements to specific assets held for specific purposes. However, the flexibility that will make capitalisation largely optional means that there is unlikely to be consistency or comparability of practice across the charity sector.

Email: caron.bradshaw@icaew.com

www.icaew.com