ICAEW representation

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HERITAGE ASSETS: CAN ACCOUNTING DO BETTER

Memorandum of comment submitted in May 2006 to the Accounting Standards Board concerning the Discussion Paper, 'Heritage Assets: Can accounting do better?'

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INTRODUCTION

1 The Institute of Chartered Accountants in England and Wales is pleased to have the opportunity to comment on the Discussion Paper entitled *Heritage Assets: Can accounting do better?* published by the Accounting Standards Board (the ASB) in January 2006.

WHO WE ARE

2 The Institute of Chartered Accountants in England and Wales (the 'Institute') is the largest accountancy body in Europe, with more than 125,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

3 The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry (DTI) through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy.

SUMMARY OF MAJOR POINTS

4 The Discussion Paper has opened up a welcome debate about how entities should provide information on heritage assets that they hold.

5 We agree that the current situation is unsatisfactory. Under the Statement of Recommended Practice for charities (the Charities SORP) 2000, entities have capitalised some heritage assets, particularly those acquired since 2001, while leaving others off the balance sheet. There is thus internal inconsistency in the financial statements of many entities holding heritage assets as well as lack of comparability between entities.

6 There are, however, substantial conceptual difficulties that need to be addressed before the proposals in the Discussion Paper can be developed into financial reporting standards. We believe that some of these problems stem from the *Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities* (the Proposed Interpretation). As we pointed out in our response to the exposure draft published in August 2005, we do not think that the discussion of assets in the Proposed Interpretation is helpful. The conceptual difficulties must be addressed before the present proposals are developed into financial reporting requirements that will have

implications for entities across the whole not for profit sector. (See paragraphs 11 to 15 below).

7 We believe that consideration of who are the key users of the financial statements published by entities holding heritage assets, and what information they want, should be the starting point for developing accounting proposals. We recommend that the ASB expand the 'defining class of user'. (See paragraphs 16 to 22 below).

8 There are conceptual issues arising from the definition of heritage assets that need further thought. (See paragraphs 23 to 25 below).

9 We are concerned about the practical considerations for entities holding heritage assets, notably in undertaking or procuring the necessary valuations. (See paragraphs 26 to 31 below).

10 In conclusion, we have serious reservations about the framework within which the proposals in the Discussion Paper have been developed, and some of the practical implications. However, the proposals offer one way forward from the current unsatisfactory position in the short term.

Conceptual considerations

11 The Discussion Paper illustrates the difficulties arising from the inadequate consideration of assets in the Proposed Interpretation, which states that: "Assets are rights or other access to future economic benefits controlled by an entity as a result of past transactions or events … for public benefit entities, an asset can embody service potential, as well as or instead of cash flows. Service potential is the ability to be utilised to provide expected future goods or services (i.e. they fulfil a need or want of the identified customers/beneficiaries) in furtherance of the entity's objectives".

12 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 under trusts or legislation to maintain the assets.

13 Heritage assets often do not even embody service potential in any measurable form. We consider that the question of assets held by an entity only because it is obliged to do so under the provisions of a trust or legislation should be addressed when the Proposed Interpretation is revisited.

14 There is a problem in including heritage assets on the balance sheet when money does not constitute the appropriate measure. The real value of heritage

assets is measured in terms of the knowledge and culture that they will impart in future periods, and such ‘units of public benefit’ do not fit the monetary framework of the balance sheet.

15 We should point out that the proposed requirement for current value to be the basis for the measurement of heritage assets is at odds with FRS15, which allows entities to choose between historical cost and valuation for tangible fixed assets.

Users of the financial statements and accounting for stewardship

16 We consider that it would have been better to start this project by questioning who are the key users of financial statements published by entities holding heritage assets, and what information those users want or need. This would help the ASB to decide on the most appropriate accounting treatment.

17 In line with the Proposed Interpretation, the Discussion Paper suggests that the ‘defining class of user’ of the financial statements of public benefit entities is the funders and financial supporters. We suggest that in this context the definition of key users of the financial statements should be extended to include the trustees, the Charity Commission or other regulator (where relevant) and potential beneficiaries, who may well not use the financial statements as a basis for making economic decisions.

18 The Discussion Paper states that the objective of financial statements is to provide information about the reporting entity’s financial performance and financial position that is useful to a wide range of users for assessing the stewardship of the entity’s management and for making economic decisions. We agree that stewardship is central to reporting performance in relation to heritage assets, but again, not in the same way that directors of for profit entities account for their stewardship of shareholders’ funds, in financial terms.

19 Stewardship in the context of, say, a charity holding heritage assets in accordance with its stated objectives means discharging a trust to maintain the assets and maximise public benefit from them. Information about transactions in and the maintenance of heritage assets, where these result in a flow of funds, may be more relevant to key users than balance sheet values, because they are likely to be interested in the efficiency, economy and effectiveness with which those responsible for managing the entity discharge their stewardship obligations.

20 The capitalisation of heritage assets may not add anything to users’ understanding of the reporting entity as an organisation or of its ability to spend money wisely in support of its objectives. We think it is unlikely that views have changed since the 1989 FASB survey of users and potential users

of financial statements in the US concluded that “most [respondents] did not believe the usefulness of information gained by retroactive capitalization of prior acquisitions would exceed the costs to provide that information”.

21 It is also unlikely to make much difference to an ordinary supporter or possibly even a sophisticated grant-making body, whether a heritage asset is capitalised at £1m or £100m, unless a disposal is imminent and the proceeds are ‘spendable’.

22 The current value of heritage assets may fluctuate by large amounts year on year because of changes in fashion, public interest or use. The resulting volatility if the assets are included on the balance sheet is likely to reduce further the usefulness of the information provided.

Definition of heritage assets

23 It may need to be made clearer that the proposals are not about heritage assets *per se*, but the financial statements of entities where the holding and maintenance of such assets is central to the objectives of the holding entity. This would allay some misplaced concerns about the impact of the proposals, for example on the part of smaller charities or religious institutions holding for their own operational (public benefit) use assets that are of immense historic, artistic or cultural importance. Such assets would fall outside the scope of the proposals because their maintenance for their contribution to knowledge and culture is not as central to the objectives of the entity holding them as the (usually non-economic) operational use to which they are currently being put.

24 However, we consider that the proposed definition is too simplistic. Many entities do not have as a stated objective the holding or maintenance of assets for their contribution to knowledge and culture, but they may use such assets from time to time to support their work, for example by making rare historic materials or items of scientific or cultural interest available to scholars and the general public.

25 We do not consider that there should be a narrow focus on the objectives of an entity when considering the relevance of heritage asset accounting. The reporting issues arise for an entity holding assets with historic, artistic, scientific, technological, geophysical or environmental qualities, whether or not contributing to knowledge and culture is central to its objectives. Some entities, such as ancient religious or educational establishments, cannot (without detriment) be separated from the fabric of their buildings. We question whether a distinction can be drawn between entities where knowledge and culture are central to the objectives of the entity and those where they are ancillary or even incidental.

Practical considerations

26 The most important practical consideration for many reporting entities is that, as recognised by the Discussion Paper, the costs involved in valuing many heritage assets may be far greater than the benefit to users. The expense of valuing items would reduce the funds available for spending on the public benefit objectives of the entity.

27 There are presentational issues arising from both capitalisation and note disclosure. Whether heritage assets are capitalised or restricted to note disclosure, the amount of information suggested as being necessary will add considerably to the volume of the financial statements produced by relevant entities.

28 Valuation techniques are not well developed for many types of item. Valuation is likely to be subjective in many cases and we do not think that comparability between entities will necessarily follow from the inclusion of heritage assets on their balance sheets.

29 Another major consideration for some entities would be the increased security risk that could arise if attention were to be drawn to the economic value of certain items.

30 Despite our concerns about the conceptual grounds for capitalising heritage assets at current value, a practical effect of the proposals is that entities could be forced to derecognise assets that are currently included on their balance sheets, with unintended and unfortunate consequences.

31 In our view the perceived shortcomings arising from the current requirements, of uneven and inconsistent reporting, would be mitigated substantially by better disclosures about heritage assets in the notes to reporting entities' accounts.

SPECIFIC QUESTIONS

(a) Do you agree with the definition of heritage assets proposed for financial reporting purposes? If not, what definition would you propose?

32 We agree with the general principle, but we believe that the definition will need to be refined if it is to be workable for the reasons set out in paragraphs 23 to 25 above.

(b) The Discussion Paper proposes that where heritage assets are reported in the balance sheet this should be at current value rather than at historical cost as this provides more useful and relevant information. Do you agree? If

not, please give reasons.

33 Whilst current value is certainly better than historical cost for the reasons set out in section 3.8 of the Discussion Paper, it can fluctuate by large amounts year on year because of changes in fashion, public interest or use. This could give rise to accounting complexities similar to those arising from current cost accounting in the 1970s, and possibly similar confusion for users.

34 Current value will also be difficult and expensive to establish in many cases, in particular in relation to assets for which there is no, or only a very limited, market.

(c) The objective of the proposals is to improve the quality of financial reporting of heritage assets. Do you agree that, to meet this objective, it is impractical to require all entities to adopt a capitalisation approach for the financial reporting of heritage assets?

35 Yes.

(d) Do you consider that the proposals in paragraphs 4.8 and 4.9 will encourage the adoption of a capitalisation approach in appropriate cases? If not, what modifications to existing reporting requirements would you propose?

36 We appreciate the pragmatic objective of the proposals but we consider that they will still result in substantial costs and practical difficulties and are in any case irrelevant if capitalisation of the assets in question is not appropriate.

(e) Where it is clear that practical considerations prevent an entity adopting a policy of recognising heritage assets a non-capitalisation approach should be adopted. Do you agree that, in reaching this decision, an entity should have regard to whether it can obtain – at a reasonable cost – reliable valuations on an ongoing basis for the majority, by value, of heritage assets held and that this should be explained clearly in the notes to the accounts? If you do not agree, how should an entity support its decision to adopt a non-capitalisation approach?

37 We agree that the reasons for not recognising heritage assets should be explained, although we do not believe that this would always be due to practical considerations.

(f) Under a non-capitalisation approach, it is proposed that acquisitions and disposals of heritage assets should be presented outside of the income and expenditure account in a statement of change in net recognised assets. Do you support this proposal? If not, how should these transactions be reported?

38 We do not support a separate statement of change in net recognised assets, because we consider that all the financial activities of an entity should be shown in a single statement.

39 Because for a charity holding heritage assets any transactions in such assets are simply part of its charitable activities, the appropriate place to include expenditure of resources on acquiring new heritage assets would be in section B of the SOFA, separately disclosed there if this activity is a key performance objective of the charity. Details of the transactions would be given in the notes to the accounts. If there were a number of acquisitions in the period, and the cost of one were exceptionally large, it might be appropriate to show the amount on a further line within 'expenditure on heritage assets' in the SOFA.

(*g) Do you consider that it is appropriate to report other transactions related specifically to heritage assets – such as donations, grants for their acquisition and restoration costs – in a statement of change in recognised net assets? If not, how should these transactions be reported?*

40 As we have stated in paragraph 38 above, we do not support a separate statement of change in net recognised assets. The Charities SORP already requires incoming resources and resources expended on different activities to be shown separately in the SOFA, and in separate columns if restricted by donors.

(h) Do you agree with the proposed disclosure requirements for heritage assets? Are there other disclosures that are practicable and would provide useful information?

41 We support the additional notes proposed in paragraphs 5.6 to 5.17 of the discussion paper except those relating to the five year summary of financial activity. We consider that this would add considerably to the length of the financial statements so should be a matter for the entity to decide.

42 It needs to be made clearer that the examples in the Discussion Paper are just examples.

(i) It is proposed that, for financial reporting purposes, historic assets used by the entity itself and corporate art are not heritage assets. Is it appropriate at this stage to clarify the accounting treatment of these assets? If so, do you agree with the proposals in Sections 6 and 7 of the Discussion Paper?

43 Yes.

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