Dear Sir/Madam

IFAC/IPSASB CONSULTATION PAPER: ACCOUNTING FOR HERITAGE ASSETS UNDER THE ACCRUAL BASIS OF ACCOUNTING

COMMENTS ON PROPOSALS

The National Audit Office (NAO) is pleased to comment on the above Consultation Paper.

The NAO, on behalf of the Comptroller and Auditor General, carries out the external audit of all UK central government departments and a wide range of other UK and international public bodies. We will in due course carry out the external audit of the UK’s Whole of Government Accounts, which the UK government intends to produce as a consolidation of the financial statements of all parts of the UK public sector.

The NAO welcomes the Consultation Paper and considers that its proposals provide a sound way forward on the issue of accounting for heritage assets. We fully support the proposal that an entity adopt either a capitalisation or a non-capitalisation approach. We are particularly glad that the Paper has taken a pragmatic approach to this issue, though inevitably there are concerns whether implementation of these proposals would still lead to inconsistent accounting treatments and policies that are overly subjective and without robust foundation. We hope that our comments on the Key Matters set out in the Annex to this letter address some of these concerns.

In particular, we are concerned that the definition of heritage assets contains an ambiguity - it is not clear whether the purpose “central to the objectives of the entity” is contribution to knowledge and culture, or, more specifically, holding and maintaining heritage assets for such a purpose. Moreover, the definition places considerable emphasis on this purpose in determining whether an entity can account for assets which otherwise meet the definition as heritage assets. This caveat would appear to debar entities which hold heritage assets for their contribution to knowledge and culture, but do not have such a purpose as an objective, central or otherwise, from accounting for those assets as heritage assets. Lay readers of accounts may wonder why famous public assets - an example might be HMS Victory, which is held by the UK Ministry of Defence - are not treated as heritage assets. It would appear that, under this definition, the objectives of the entity effectively override the purpose or function of the assets themselves. On this basis, the accounting treatment of a heritage asset could change upon transfer from one entity to another purely because the entities’ objectives - or even the relative importance of objectives - differ, while the nature and use of the asset itself remains unchanged.
This leads to a consideration of the implications of this definition for consolidating entities. What would be the appropriate accounting treatment in the case of, for example, a consolidating entity adopting a non-capitalisation approach (because it cannot reliably value the majority of its heritage assets), whereas a component entity, holding a minority by value of the consolidating entity’s heritage assets, capitalises those assets?

In consequence of these concerns, we would welcome further discussion of the definition of heritage assets to remove possible ambiguities in interpretation and explore and resolve potentially anomalous accounting treatments by different entities, including consolidating entities.

There are some other issues where we believe the Consultation Paper could usefully expand on or clarify its proposals. These include clarification on the application of the definition of heritage assets to a range of types of entity, including consolidating entities; guidance on the circumstances in which a policy of capitalisation or non-capitalisation might change; illustration of the circumstance in which heritage transactions might distort the reporting of financial performance of entities adopting a non-capitalisation approach; and clarification on the application of disclosure requirements to historic assets used by the entity itself.

I hope that the Board finds these comments helpful.

Yours sincerely

MARK SINCLAIR
NAO comments on Key Matters

Comments on the Key Matters raised:

1. *Do you think that the definition of heritage assets in paragraph 1.16 of the Discussion Paper is appropriate? If not what definition would you propose?*

   Broadly, we agree that a consideration of the function or purpose of an asset is crucial to its determination as a heritage asset, but that the consideration of the objectives of the entity which holds it may lead to inconsistent accounting treatments. We therefore consider that the definition as it stands may be ambiguous and open to misinterpretation. We also note that there may be implications in using this definition for consolidating entities where the parent and subsidiary bodies may not have congruent objectives, or the proportions of their heritage assets which can be valued differ. We would welcome further discussion of the definition of heritage assets, and have commented in more detail on this issue in the text of the covering letter.

2. *Do you think that the proposals in the Discussion Paper are applicable to all types of heritage asset? If not please give your reasons.*

   Although heritage assets may have widely varying characteristics, we agree that the proposals in the Discussion Paper are applicable to all types of heritage asset.

3. *Do you agree with the view in Section 4 of the Discussion Paper that, where a majority, by value, of heritage assets held by an entity cannot be recognized, because reliable valuations cannot be obtained, all other heritage assets should also not be recognized? Alternatively, do you support other approaches such as those outlined in Section 3 of the Discussion Paper? Please give your reasons.*
We agree that where an entity cannot reliably value the majority (by value) of its heritage assets, it should not recognise any of its heritage assets – i.e. adopt a non-capitalisation approach. We wonder whether there might not be circumstances in which an entity adopts a non-capitalisation approach for other than purely practical reasons - for example, that the results would not be meaningful. We might consider this, if properly and clearly explained, an appropriate approach. We strongly agree that where an entity adopts a non-capitalisation approach, the reason for adopting that approach should be clearly explained in the accounts.

We consider that it would be helpful if there were guidance on the circumstances in which the policy might, or could be expected to, change. An example of such circumstances would be the donation to an entity by a (presumably rich) supporter of a recent purchase of far greater value than the aggregate value of all its other heritage assets. The entity could have previously adopted a non-capitalisation approach, but now it is clearly able to obtain a reliable valuation for the majority, by value, of the heritage assets it holds. In this situation, the entity should, under the proposals in the Discussion Paper, adopt a capitalisation approach.

4. Do you think that, for financial reporting purposes, assets that might otherwise be regarded as heritage assets, but are not held for purposes central to the objectives of the entity, should be accounted for as property, plant and equipment or investment property in line with the proposal in paragraphs 7.2 - 7.4 of the Discussion Paper? Please give reasons.

Subject to clarification of the definition of heritage asset (see our response to Key Matter 1), we agree with the proposals in Section 7 (and Section 6) – namely, that corporate art (and historic assets used by the entity itself) should be accounted for under existing financial reporting requirements for property, plant and equipment or investment property. In particular, an historic asset used by the entity itself, where it is not in itself a heritage asset, should be valued on the basis of the replacement cost of the service potential.

5. IPSAS 17 requires entities to initially measure property, plant and equipment at cost and allows the historical cost or a revaluation model to be
adopted subsequent to initial recognition. In contrast, the Discussion Paper proposes at paragraph 3.16 that where heritage assets are recognized they should be carried at current value with valuations on a regular basis. What measurement basis or bases (fair value, historical cost or another basis) do you think should be allowed or required for heritage assets that are to be initially recognized as assets? Please give your reasons, and, if a basis other than fair value or historical cost, identify that basis.

We believe that current value provides more useful and relevant information than historical cost, particularly where that cost was established many years ago, although we recognise that there will be difficulties in obtaining and supporting current values for many heritage assets. Consequently, we agree that heritage assets should be initially recognised at current value.

In many cases, historical cost will equate to current value, and its use on initial recognition will be appropriate. However, entities may often acquire heritage assets at a discount, or occasionally purchase assets which are subject to rapid revaluation (for example, a work of art whose attribution is re-evaluated). In such cases, fair value will be a more appropriate basis of measurement.

6. Where heritage assets are carried on a revaluation basis do you think that it is appropriate to relax the requirements for their revaluation below the criteria for other items of property, plant and equipment as proposed in the Discussion Paper at paragraph 4.8? Please give your reasons.

In view of the nature of heritage assets, we agree that, as outlined in paragraph 4.8, alternative and - compared with those required for other items of property, plant and equipment - less stringent valuation requirements are appropriate.

7. Where heritage assets are not recognized do you think that transactions such as acquisitions and disposals, restoration costs and grants and donations for the purchase of heritage assets should be presented in a separate statement other than the Statement of Financial Performance, as suggested and exemplified in paragraphs 4.14 - 4.16? Do you think that
IPSASs should be amended to include such an additional statement? Please give your reasons.

It is our understanding that an entity would only prepare a “statement of change in recognised net assets” where it had contribution to knowledge and culture as a central objective – and thus, presumably, a principal activity. In these circumstances, reporting heritage asset transactions as a separate ‘group’ might be useful to the reader of the accounts, but we are not clear why these transactions – relating to a principal activity of the entity - should be excluded from the statement of financial performance. We would welcome an illustration of circumstances in which such transactions could be said to distort financial performance.

Insofar as there is a case for a separate statement, we agree that the IPSASs should be amended to include such an additional statement.

8. IPSAS 17 and IPSAS 21, Impairment of Non-Cash Generating Assets specify requirements for the depreciation of property, plant and equipment and impairment of assets primarily held for service delivery purposes. What requirements, if any, do you think should be applied to heritage assets for depreciation and impairment testing? Please give your reasons.

Where heritage assets are capitalised, they should be subject to the same requirements as other service-delivery assets, so that heritage assets that have a clear useful life are depreciated, and impairments in the value of heritage assets, whose condition can be shown to have been impaired, are recognised.

However, because of the nature of heritage assets, we believe that such cases will be rare: many heritage assets have an indefinite life; and many heritage entities have as one of their objectives the maintenance of the condition of their heritage assets. We would also note that the condition of the heritage asset is often an intrinsic element of the valuation of that asset, and it may not always be possible to differentiate between true impairments and simple downward market revaluations.

9. Do you agree with disclosure requirements proposed in Section 5 of the Discussion Paper? If you think that the disclosures are too onerous or,
alternatively, inadequate please indicate which disclosures should be omitted, or which further disclosures should be inserted.

We agree with the disclosure requirements proposed in Section 5, except for the requirement for a five year financial summary of activity. We regard this as an unnecessary requirement, given that the information would be available in previous years’ accounts, and propose that it should be an optional disclosure.

We would suggest adding that where the holding of heritage assets imposes onerous obligations, these liabilities should also be disclosed, and that entities should also disclose any physical losses or impairments of heritage assets suffered.

We believe it would be useful if the section on disclosure (paragraphs 5.6 to 5.18) could clarify whether these requirements would apply to historic assets used by the entity itself, and, if so, how (paragraph 6.5 refers to the disclosure of the “heritage qualities” of such assets).

10. Do you think that the proposals in the Discussion Paper have particular audit implications? If so, please outline what these implications are.

We believe that auditors may have difficulties assessing an entity’s contention that it is not practicable to obtain valuations. Deciding whether valuations are sufficiently “reliable”, or whether the cost of obtaining valuations is “prohibitive” or “reasonable”, is highly subjective, and leaves much scope for disagreement. It may be difficult for the auditor to challenge management assertions, particularly where there is no comparative experience on which to draw. Given that there may be a temptation for some entities to avoid capitalisation by means of claiming the impracticability of obtaining valuations, this could be a significant audit issue.

We also believe that there may be difficulties in auditing the valuation of heritage assets where they are obtained. Some heritage assets, such as works of art, are subject to significant volatilities in market value. For other heritage assets, there may effectively be no market. There may be a
number of experts available, each providing a different valuation, or only one, employed by the entity itself.

It may thus not be possible to come to a true and fair view of the value of heritage assets, or to agree on the practicability of obtaining valuations. In both cases, this might lead to an increase in the number of opinions appearing with a scope limitation.

11. IPSAS 17 specifies requirements in relation to property, plant and equipment held for operational purposes. Do you think that the IPSASB should develop requirements for heritage assets by amending IPSAS 17 or do you think that heritage assets should be addressed in a separate Standard focusing specifically on heritage assets? Please give your reasons.

We believe that the issue of accounting for heritage assets, particularly in the public sector, is sufficiently significant and complex to warrant a separate IPSAS.