

LGA response : HMT Thematic Review of Non-investment Asset Valuation for Financial Reporting Purposes

May 2023

About the Local Government Association

1. The Local Government Association (LGA) is the national voice of local government. We are a politically led, cross party membership organisation, representing councils from England and Wales.
2. Our role is to support, promote and improve local government, and raise national awareness of the work of councils. Our ultimate ambition is to support councils to deliver local solutions to national problems.
3. This response has been cleared by the LGA's Resources Board.

Introduction

4. The LGA welcomes this review and consultation on the options. The valuation of non-investment assets for financial reporting purposes has been a contributory factor to the current crisis in local audit and how the valuation of such assets is audited is an area that needs to be addressed if the crisis is to be solved. Clearly how the assets are valued in the first place is an important step in that.
5. While the full outcome of the review has not been published, it is encouraging that the consultation document acknowledges that local authorities have had particular difficulties under the current arrangements, recognises that “the cost burden was felt most acutely in English local authorities” (para 3.9) and that the proposals in the consultation represent an attempt to address that.
6. The consultation includes many detailed technical questions and it is not our intention to answer the questions individually; instead, we will comment on the overall approach and highlight where we believe further improvements can be made.

LGA views on the proposals

7. The overall approach being suggested in the consultation (under the preferred option 3) is that a different approach should be taken to valuation of different types of assets. We think this is the right approach and it is welcome that this represents a willingness to diverge from International Financial Reporting Standards (IFRS) where it is clear that these do not add value and potentially cause problems. Such a practical attitude is to be welcomed.
8. The consultation identifies a number of different asset classes. We agree that these broadly cover the right areas and will provide a useful distinction between the different types of assets and how they should be approached. We are also in broad agreement with the proposals for most of the classes, although we suggest that an alternative and more practical approach should be taken to networked assets (usually called “infrastructure assets” in local authorities). This is the area that has been making a significant contribution to the current crisis in local audit

and we do not think that the proposals on the consultation go far enough (see below).

9. Dealing with the other classes first, the distinction between specialised assets (PPE) and non-specialised assets (PPE) in the proposals is helpful. Valuation of Property Plant and Equipment (PPE) has also contributed to the current crisis in local audit, where the process has meant auditors have spent a lot of time on the valuation of assets where the actual value plays little role on decision making nor has a great deal of meaning (as there is no market for the asset in its current form nor would there be any intention of selling it). It is therefore welcome that the proposals recognise this with the proposed class of specialised assets (PPE) and proposes that the valuation of these should be done on a historic cost basis. This should make it clear that there is no need for auditors or preparers to obtain independent or external valuations. This should be a helpful contribution to reducing the local audit burden.
10. The alternative approach for the proposed class of non-specialised assets (PPE) is also supported. These are assets that could potentially be sold, so it is right that the figure in the accounts is meaningful. The suggested move to fair value therefore seems to make sense, though account should be taken of any further comments made on this proposal by technical specialists from individual local authorities.
11. For heritage assets, social housing assets and surplus assets no changes are proposed. We support this within the context of the consultation and note the comment that the approach to valuation of social housing assets is a matter for CIPFA / LASAAC rather than for HMT.
12. For intangible assets we support the move to historic cost and agree with the comments that this is well understood and easy to measure and that there is little value from alternative approaches as the assets cannot be sold or put to any alternative use.

Networked Assets (infrastructure assets)

13. As mentioned above, problems with valuing networked assets have made a major contribution to worsening the current crisis in local audit. In local authority terms these assets are usually referred to as infrastructure assets and are primarily highways.
14. The consultation shows that local authorities' approach to valuing these assets has varied from the approach taken in the rest of the public sector. The proposal is for local authorities to move to the same basis of valuation used by the rest of the public sector, that is depreciated replacement cost (DRC). We think there are several problems with this. We also believe that this will not help resolve the current crisis in local audit.
15. There is a lot of important and useful financial information that relates to these assets and their condition and this is used to manage their maintenance and use. It is hard to see that the published accounts is the right place for such information. It should be reiterated that, certainly in the case of local authorities, networked assets cannot and will not ever be sold. The value placed on them will not significantly impact on any decision making (unless in a negative way by skewing the view of other items in the accounts – see below). The value placed on them in the accounts **as a financial asset of the local authority** can never be more than

a notional figure, no matter how sophisticated the measurement process.

Therefore, the measurement needs to be as simple as possible and one that is unlikely to be disputed or lead to additional and unnecessary work by accounts preparers and auditors. Unfortunately, DRC is unlikely to meet either of these criteria and we call for this to be reconsidered.

16. Using DRC will have at least two negative impacts.

- Firstly, it will mean that a great deal of time and effort will be spent producing a figure that will have no real meaning but will still need to be subject to audit.
- Secondly, it is expected that the application of DRC to highways assets will mean a massive increase in the (notional) value of these assets reported in the final accounts. Some local authorities expect that this will mean that the figures will exceed the value of all other assets in their accounts. This will significantly distort the figures and give a highly skewed picture of the finances of the local authority. It is possible to expect a scenario where figures for other areas that actually matter are masked or lost amongst these excessive values. This cannot be seen as high-quality financial reporting.

17. There needs to be change in how figures relating to infrastructure assets in the published accounts are viewed. Accepting that the figures in local authority final accounts for values of infrastructure assets can never be more than notional will enable a more radical and realistic approach to be taken. For example, the valuation of local authority infrastructure assets could be undertaken on a standard cost basis – such as a standard value for each mile of road. This would then mean that the value in the accounts would be easy to calculate, easy to audit and it would be based on real service information that should already be in the accounts. Depending on the standard value used the figure itself could be set so that it does not distort the view of the finances of the local authority (although as a notional figure it might be better to report it separately). More importantly it would not hold up the process of auditing the accounts. It would also facilitate comparisons between the figures reported by different local authorities.

Conclusion

18. As outlined, we have not answered the individual questions in the consultation.

We are supportive of the approach suggested in the preferred option (option 3), in accepting that there should be different approaches to different asset classes and that these different approaches should diverge from IFRS where appropriate.

However, we do not agree with the valuation methodology proposed for networked assets (roads) in local authorities and we believe that there is a strong case for an alternative pragmatic, practical and sensible approach for this. We would be happy to discuss the points raised in this response and to collaborate on taking them forward.

Contact:

Bevis Ingram

Senior Adviser Finance

Phone: 079 2070 2354

Email: bevis.ingram@local.gov.uk