Harmsworth House, 13-15 Bouverie Street
London, EC4Y 8DP

t: 020 7674 2431
f: 020 7674 2308

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

Your Ref:
Our Ref:

Date: 20 April 2007

ED 40: Accounting for heritage assets

The Charity Commission is established by law as the regulator and registrar for charities in England and Wales and the Office of the Scottish Charity Regulator is the independent regulator and registrar of Scottish charities; and together, we form the joint SORP-making body for UK charities. This response to your consultation is made in our capacity as the joint SORP-making body and reflects the views of our SORP Committee and is informed by round table consultations with those parts of our sector affected by the proposals.

Whilst we welcome this initiative, there are a number of areas where the proposals, contained in the exposure draft, cause us significant concern. The discussion paper 'Heritage Assets: Can Accounting do Better?" was generally well received by our SORP Committee. The ASB's subsequent decision that the question of practicability of valuation should be applied on a collection by collection basis has come as a disappointment to us. We continue to favour the approach put forward in the discussion paper whereby recognition is based on the practicability of valuing the majority of heritage assets held. This view was also overwhelmingly supported by those attending our round table events.

Both our SORP Committee and those attending our round table events welcomed the emphasis placed on disclosures in the notes to the accounts. A view exists that good qualitative information as to the nature, scale and importance of heritage assets has greater relevance to the majority of users than is offered by the partial, and perhaps inconsistent, recognition of such assets within the balance sheet.

Our primary concern remains that the approach put forward, in the exposure draft, creates another dual accounting policy which may result in some collections being valued and others not within the same entity. We do not believe this approach can provide relevant information to users particularly when those collections capitalised represent only a small part of the entity's total holding of heritage assets. Also an administrative decision on the boundaries between collections will determine accounting policies and result in differing recognition policies being adopted according to how such boundaries are drawn up.

We also have some concerns that the definition of heritage assets does not extend to medieval cathedrals, abbeys and artefacts dedicated to worship which may not be held for specific heritage or preservation objectives but would be seen by most as having a heritage as well as a faith dimension. Similar recognition issues have arisen in the context of such structures and artefacts in the absence of historical cost information and the practical difficulties associated with their valuation. These issues will remain unaddressed if charities holding such assets are expected to continue to look to FRS 15 for accounting solutions.

Concerns have also been raised with the SORP Committee as to the likely costs of valuing heritage assets, either for the first time or in changing from an historical cost basis of valuation under FRS15 to a current valuation in line with FRED 40. However, in our view, the practicability test addresses this issue. Nevertheless, uncertainty exists as to how the frequency of valuation might be determined. The exposure draft's flexibility on this issue may also have inadvertently created uncertainty as to how the period between valuations might be justified in an audit context. Moreover, significant costs may be incurred in determining if a fresh valuation is required. Extensive review work might be needed, with potentially significant cost implications, simply to establish the ongoing relevance of the balance sheet carrying value of heritage assets. The standard could usefully advise a recommended frequency, leaving discretion with the entity to justify an alternative frequency where appropriate.

We attach in an appendix to this letter our responses to the specific questions raised by your consultation which we would be happy to discuss with you.

Yours sincerely

Andrew Hind
Chair of Charities SORP Committee

Kirsty Gray
Deputy Chair of Charities SORP Committee

Appendix

The Charities SORP Committee's response to ED 40: Accounting for Heritage Assets

Question 1: Should heritage assets be valued where practicable and will this lead to an improvement in the quality of financial reporting

In principle, we concur that heritage assets should be recognised on an entity's the balance sheet. However, unlike other tangible fixed assets, their contribution to an entity's performance, at least as reflected in an entity's performance statement, is more tenuous. Heritage assets may not generate cash flow and whilst the benefits generated in terms of knowledge and cultural understanding may be immense, this utility cannot always be gauged in the same way as other service providing assets. For example, a fragile artefact or tomb may have limited public access in order to secure its preservation but its benefit or utility in heritage terms would be undiminished.

In so far as the link between heritage assets and financial performance is tenuous then the secondary argument for valuation is stewardship reporting. Often the objective of stewardship reporting can be achieved in qualitative reporting through notes. The conceptual question of what exactly valuation is trying to achieve is still a question that parts of the sector believe has not been fully addressed and is perhaps, at a principle level, at the root of what might be seen as a reluctance by many organisations to capitalise heritage assets.

We are not fully convinced that the test of practicability will work as intended. A similar test was introduced by SORP 2000 in relation to heritage assets previously acquired but not capitalised. In practice, the sub-sectors affected generally took the view that previously non-capitalised heritage assets should not be capitalised using the cost/benefit test allowed for in the SORP's guidance. There is no evidence to suggest that a different conclusion will be reached in the context of the proposed practicability test, put forward by the exposure draft, which also relies on a cost/benefit analysis undertaken on a collection by collection basis.

Whilst it is clear that the proposals, even as they stand, are an improvement on existing accounting arrangements, we strongly believe the ASB needs to reconsider the level at which the test of practicability is applied . The approach put forward in the ASB's earlier discussion paper, which applies the test at the level of an entity's total holding, offers a way forward that is supported by the Charities SORP Committee and, in our view, by the vast majority of the sector affected.

Question 2: Should the assessment of practicability be applied at individual collection level?

In our view no, as noted above, our strong preference is for the test of practicability to be applied at the level of an entity's total holding of heritage assets. In our view a valuation approach on a collection by collection basis

The Charities SORP Committee’s response to ED 40: Accounting for Heritage Assets

has little relevance to the information needs of users. It provides limited information as to total holdings, or the conservation, acquisition and public access policies inherent in good stewardship.

Clearly an understanding of total value is relevant in assessing performance and stewardship but we are not confident that the partial approach suggested will meet such information needs. The valued collections will be included in the balance sheet even where they may represent only a small proportion of heritage assets held. Even with clear accounting policy disclosures there is a clear risk of misinterpretation and misunderstanding on the part of users of accounts. What does the valuation represent? Is it a small or large part of the total?

The accounting policy would be dependant on management and administrative definitions of what constitutes a collection – for example, a single exhibit could constitute a “collection” if regarded as a distinct part of an entity’s holdings. Simply redefining “collection boundaries” could significantly affect capitalisation policies – thus if assets capable of valuation were reclassified to a new collection, that is not valued, then their value might need to be removed from the balance sheet. We believe this may also create audit difficulties as auditor struggle to understand the legitimacy of boundaries between collections.

Question 3 – Is the definition of a “collection appropriate”

The definition will only work if preparers of accounts are willing to embrace the spirit of the definition. The boundaries between collections are largely dependant on an entity’s management and administrative policies. Collection boundaries would be open to manipulation – thus if assets capable of valuation were reclassified to a new collection or diluted in the context of a broader collection, that is not valued, then their value might be removed from the balance sheet.

Feedback from our round table events indicates that collections can be defined in many ways. For example, an art collection could be defined by period, style, country or artist. How boundaries are set could clearly affect the outcome of the practicability test.

Question 4: Should valuations only be used that are reliable rather than when useful and relevant?

A valuation approach on a collection by collection basis, where not all collections are valued, provides limited information as to total holdings and will therefore be of limited value to users of accounts. It is hard to imagine how

The Charities SORP Committee's response to ED 40: Accounting for Heritage Assets

such limited information could have relevance to users of accounts or the ability to influence economic decisions.

Clearly for information to have relevance there must be reasonable confidence in the reliability of the information presented. However, placing too high a demand on reliability will significantly increase compliance costs and if compliance costs become too great then fewer charities will see valuation as a practicable option (based on cost/benefit consideration). On balance therefore we would accept that the concepts of useful and relevant information are appropriate criteria to be applied in assessing practicability.

Question 5: Will assessing practicability and valuation bases present auditors with difficulties

A test of practicability will always be problematic as it is effectively a cost/benefit test. Costs of a valuation may be a "known cost" but the benefit accruing to users of accounts and management is extremely judgemental. Similarly, relevance is judgemental and reliability can only be assessed based on the use of an agreed methodology in the absence of expert knowledge. Judgements are likely to vary considerably as to the weight to attach to reliability when assessing practicability.

The views of the audit profession and audit standard setters will be of particular relevance to this question. Audit guidance in this area would clearly be desirable.

Question 6: Should heritage assets additions and disposals be kept outside the performance statement

Yes, we agree that movements in tangible fixed assets should be kept outside of the performance statement. Including additions or disposal proceeds in a performance statement would lead to significant variations in perceived operational performance.

The Statement of Financial Activities (SoFA) will undoubtedly be more complex. For example, non-capitalised additions and disposals will be recognised in the section of the SoFA dealing with Changes in Recognised Net Assets– the following section of the SoFA will identify movements in the current value of those collections which has been capitalised. Clearly, careful reading of accounting policy disclosures will be central to a proper understanding and interpretation of this information.

Moreover, anomalies might arise. For example, it may be possible to value a donated asset which is recognised as income in the performance statement,

The Charities SORP Committee's response to ED 40: Accounting for Heritage Assets

only to find that the addition form part of a collection that is not practicable to value resulting in a matching entry in Changes in Recognised Net Asset to eliminate its recognition.

Again, these complexities are ameliorated when the test of practicability is applied at a total holding level as charities will either have a capitalisation policy or they will not.

Question 7: Adequacy of enhanced note disclosure

In general, we welcome the additional note disclosures proposed. We believe that information as to the nature, scale and use of collections is fundament to an understanding of the activities of the sub-sector affected. We believe that these might be enhanced by further disclosures in relation to public access to collections particularly in the context of charities that need to be able to demonstrate their public benefit purposes.

We have some reservations as to the five-year financial summary but welcome the concession that these disclosures can be built up over time. Our preference would be for this information to be provided in accompanying information, rather than though notes to the accounts, where preparers believe this information assists users' understand an entity's acquisition and disposal policies.

Question 8: The definition of heritage assets

The definition provided in paragraph 8 is workable, subject to one significant exception; however, the phraseology used in other parts of the text is more ambiguous and may create misunderstanding. For example, paragraph 3 of the exposure draft talks of promoting "knowledge" but fails to limit this to the context of knowledge gained through access to the heritage asset.

There is, however, a very significant issue that arises in relation to assets that have cultural or faith dimensions. Medieval cathedrals and abbeys and the artefacts they hold, for example, may not have specific heritage or preservation objectives but would be seen by most as having a heritage as well a faith dimension. It is clearly desirable that the definition of a heritage asset is drawn sufficiently broadly so as to include such structures.

Some may argue that similar considerations also apply to the historic buildings occupied by our ancient universities and colleges and artefacts held by armed services charities. The structures and artefacts that they house are seen by some as contributing to the culture of such establishments which over generations, have clearly seen inherent preservation objectives in their ongoing use.

Appendix

The Charities SORP Committee’s response to ED 40: Accounting for Heritage Assets

Question 9: Regulatory costs

The regulatory impact assessment provided is rather incomplete. Clearly, much will depend on how the test of practicability is applied in practice.

Where a charity adopts a full valuation approach, heritage assets may often be the most material item on the balance sheet. We would anticipate a significant increase in audit costs arising. Similarly, even where internal valuations are used, internal staff costs may be significant. Even where a non-capitalisation policy is adopted costs will arise, in year one, as the test of practicability is considered.

The argument put forward that the valuation is only required where the benefits exceeds valuation costs and therefore a low regulatory cost result is an interesting proposition. However, if ASB believe these proposals will result in significant take up of the valuation approach then significant costs are likely to arise.