



Accounting standards and the property manager: a case study

Accounting
standards

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Abstract *Traditionally in the UK, accountants and their concepts of value have held little interest for those involved with the technical aspects of property management. Indeed, property valuers and accountants have traditionally adopted differing professional approaches towards the concept of valuation, despite nominally agreed valuing practices dating back to 1974. Most particularly, notwithstanding these agreements, the accounting profession has regarded the theory of property valuation for company accounts as a monopoly of its professional domination of the creation and implementation of accounting standards. Because of the lack of a codified conceptual framework, property assets were regarded identically to other assets. Equally, property managers attended to technical, infrastructural and legal aspects of managing properties. Examined in this paper, the development process behind Financial Reporting Standard 15: Tangible Fixed Assets (FRS 15) provided a realistic and fundamental shift of attitude. Not only were the opinions of valuers actively sought over the issue, but also the final standard adopted the definitions of value created by The Royal Institution of Chartered Surveyors (RICS). Moreover, property assets now figure prominently in financial statements and so impinge directly on the net asset value and borrowing capability of the firm. Property management and modes of holding property have become central to running the business. This paper examines some of the arguments presented within the discussion process undertaken in the creation of FRS 15, highlighting the different approaches to the issue, and noting the likely negotiations to the standard to follow.*

Introduction

UK property managers have traditionally had little involvement with the financial management and reporting of companies. Whilst they play an important part in ensuring that business can operate in an efficient manner, and despite the role played by valuers in the measurement of value for the property sector, the entire property profession has tended to play a subservient role to the accounting profession in terms of its contribution to the creation of accounting standards, and thus how property is valued by companies for the purposes of financial reporting and auditing (see, for example Eccles and Holt, 2001; Holt and Eccles, 2001). This paper uses the development of a UK financial reporting standard (FRS) as the basis for exploring the complex technical interactions that may take place when two competing bodies of professional knowledge collide, and the effect this has had upon those who seek to manage property[1]. Particularly, the paper examines the increased recognition for the views of chartered surveyors, and examines the debate over the creation of a standard means of calculating value for both surveyors and accountants. The standard under investigation is FRS 15: *Tangible Fixed Assets* (ASB, 1999) issued by the Accounting Standards Board (ASB) in February 1999. The

objective of FRS 15 is to ensure that uniform and consistent principles are applied to the initial measurement, revaluation and depreciation of tangible fixed assets. The accounting profession, acting in its role as the guardians of accounting knowledge, traditionally has had the largest input into shaping and guiding the development of any given FRS. However, in the case of FRS 15, they were not the only profession with an intellectual claim to the valuation of tangible fixed assets. Surveyors and other property valuers have a large and established body of knowledge about the types of valuation methodology that must be applied to different types of property assets, and have a codified set of procedures enshrined in the *Appraisal and Valuation Manual* (RICS, 1996).

It should be noted that the two professions have worked together since 1974, when a joint working party consisting of members of the Institute of Chartered Accountants in England and Wales (ICAEW) and The Royal Institution of Chartered Surveyors (RICS) adopted a single code of valuation (ICAEW, 1974). In addition, the RICS assets valuation standards committee (*inter alia*) has been involved with the creation of standards, promoting the interests of the valuation profession. The primary difference within the creation of FRS 15 was that representation at non-institutional level from within the property industry was specifically encouraged, and reflected in the final accounting standard. Like the RICS, property companies and professionals involved themselves in earlier consultations (see, for example, ASB, 1993b), but the debate within FRS 15 is particularly illustrative of the technical differences between and within the two professions, and an exemplary case study on the pragmatic results of such views. Indeed, it also illustrates (as will be seen) the dangers of the earlier position, where it appears to have been assumed (given the paucity of responses) that the RICS served *ipso facto* the interests of all property concerns. If this is not so, it displays an alarming degree of ignorance by the industry about the creation of standards (see, for example, Eccles and Holt, 2000; Holt, 2001).

Written submissions to the ASB from property-owning companies, as part of the consultations for FRS 15, ultimately helped to shape debate away from a purely accounting perspective. Suddenly, the urge to improve the consistency and conceptual practice of accounting – linked to the theory of valuation – had to be balanced much more with a need to consider the practicalities of valuing property. Accounting, without a codified conceptual framework to guide its development, found itself faced by both a rival profession (with an already established methodology and notion of property “value”) and an assorted group of property owners and users with pragmatic interests to pursue. As its development progressed, FRS 15 became a compromise, with the scope of the accounting standard being limited by practical concerns, and incorporating value definitions as defined by the surveying profession. This final point is fundamental. It is very rare indeed for the UK accounting profession to adopt the definitions of another profession. It is unclear whether this adoption was the result of the strength of the surveying profession’s submissions during the consultation, their historic professional negotiation over the issue, or a conscious decision taken by the ASB in order to gain legitimacy and support

for the new standard by utilising formalised practice from elsewhere. Whilst not unique, FRS 15 provides an interesting case study in which to study these interactions, and one where professional gestalts meet with commercial realities in the field of property. This paper explores the specific constellation of debates, issues, pressures and interest groups that formed during the development of FRS 15. From this, an analysis is made of the role played by the surveying profession and the property industry in influencing the actions and publications of the UK accounting standard setting body.

Why was a new standard needed?

The main objective of FRS 15 was to “ensure that tangible fixed assets are accounted for on a consistent basis, where a policy of revaluation is adopted, that revaluations are kept up-to-date” (ASB, 1999, paragraph 1). Prior to the introduction of FRS 15 in 1999, many entities had adopted a policy of revaluing specific tangible fixed assets. This was deemed perfectly acceptable practice, even though there were no detailed accounting guidelines to follow when conducting a valuation. Such valuations were allowed by the alternative accounting rules of the Companies Act 1985[2], and were also seen as a practice that guaranteed a “true and fair” view of asset values in the annual report. Replacing the cost of an asset with a more accurate valuation was seen as a way of providing more relevant information to the users of accounts. For example, 65 per cent of the 543 UK companies included in the survey database of *Company Reporting* in February 1997 carried revalued assets in their accounts (*Company Reporting*, 1997). However, the practice permitted valuations of assets to be made at the entity’s discretion, with no requirement for valuations to be updated in subsequent periods. Entities could, and did, “cherry pick” which assets they wanted to revalue. What made matters worse was the fact that similar types of assets did not have to be treated identically, so some could be shown at their historical cost whilst others could be shown at current value. If all of this was not bad enough, the vast majority of revaluing companies did not even disclose their policy on the frequency of valuations.

Clearly, existing accounting valuation practice allowed entities to be both creative and secretive when accounting for a pool of similar fixed assets. Assets which had declined in value might be left at historic cost, whilst others that had appreciated would be shown at valuation. As a result, it made the process of deciphering the resulting accounting figures very difficult. This was compounded by the fact that entities were not compelled to conduct frequent and up-to-date valuations of their assets, thereby further hindering comparison between different entities. An entity could revalue its assets upwards when the economy was growing, but was never forced to devalue the same assets during a recession – allowing creative accountants to distort quite legally the reported values of assets. The extent of this problem was clearly illustrated in the *Company Reporting* survey from February 1997 which found that of the 65 per cent of companies revaluing assets in their accounts, 50 per cent did not have any valuations that were more recent than five years old (*Company Reporting*,

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1997). This was not acceptable to either the ASB or the users of accounts. Action was thought long overdue on the accounting guidelines surrounding the valuation of assets, and the ASB's first discussion document on the subject was issued in 1993.

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The consultation process behind FRS 15

The genesis^[3] of FRS 15 came with the publication in 1993 of the ASB discussion document *The Role of Valuation in Financial Reporting* (ASB, 1993a). The document attempted to ascertain views on what basis asset valuations might be conducted, and what they were aiming to convey in the accounts. The majority of respondents to the document favoured retaining the existing modified historical cost system, which gave the firms the option of revaluing certain tangible fixed assets including property. However, it was clear from the discussions that there was a need for a dedicated accounting standard on valuation in order to clear up the anomalies and vagaries in accounting practice across firms. FRS 15 was to provide this.

As is commonplace with the development of any new or revised UK accounting standard, FRS 15 emerged only after a lengthy consultation process had been carried out with all interested parties. The first stage in the development of the new standard came with the publication of the Accounting Standard Board's discussion paper *Measurement of Tangible Fixed Assets* (ASB, 1996) in October 1996. The initial proposals from this paper were revised in view of the comments received, and formed the main basis of Financial Reporting Exposure Draft (FRED) 17 *Measurement of Tangible Fixed Assets* (ASB, 1997) which was issued in October 1997. FRED 17 laid out the first draft of the detailed guidelines that would form the bulk of the finished financial reporting standard. Comments received on FRED 17 led to further revisions and the development of the final FRS document. FRS 15: *Tangible Fixed Assets* (ASB, 1999) was finally issued in February 1999.

The response from the property profession to these two consultations is quantified below.

- (1) Measurement of tangible fixed assets
 - Total number of responses: 106
 - Property firms: 15
 - Property institutions: 5
 - Property owners: 39.
- (2) FRED 17: measurement of tangible fixed assets
 - Total number of responses: 74
 - Property firms: 12
 - Property institutions: 3
 - Property owners: 20.

The main debates within the consultation process

Attention is now focused on the main issues and recurring themes mentioned in each of the discussion documents that were issued leading up to the finished FRS 15. Whilst some of these issues were dominated by the accounting profession, the vast majority included vocal representations from various members of the property profession. The role of the property profession, and the way their representations were interpreted by the ASB are vital indicators of the way professional power can pass beyond the normal boundaries of one profession and into another profession's body of knowledge.

The first discussion paper issued by the ASB *Measurement of Tangible Fixed Assets* (ASB, 1996) posed questions about many aspects related to tangible fixed assets. It emerged from discussions from ASB board members, and included differing views about the best accounting practice to use when dealing with certain issues. The responses to this, and the subsequent ASB publications, provoked a series of debates about the valuation of fixed assets. Some of these issues were resolved and some were deferred. In addition, the importance and impact of others were not fully appreciated by the property profession.

The call for a dedicated financial reporting standard on tangible fixed assets

Until the introduction of FRS 15, the accounting guidance for tangible fixed assets came from two main sources, Schedule 4 of the Companies Act 1985 and the existing accounting rules for tangible fixed assets contained within SSAP 12: *Accounting for Depreciation* (ASC, 1977; revised ASB, 1992). Schedule 4 of the Companies Act 1985 states that assets should be capitalised at their "purchase price or production cost", but does not give detailed guidance on how to perform such calculations. If revaluations of such assets were to be included in the accounts, the Companies Act is also less than clear on how often such revaluations should take place, on what basis, and by whom.

Such problems were also not directly addressed by SSAP 12, a standard that dealt primarily with the depreciation, not the valuation, of tangible fixed assets. Although to the non-accountant this may seem a somewhat surprising state of affairs, the problem has arisen from the highly unique nature of accounting regulation and guidance in the UK. The accounting profession in the UK is largely self-regulating, and encompasses the rationale that a professional accountant has the necessary expertise and skills to decide on the best accounting practice to adopt in any given situation. As a result, detailed and prescriptive accounting standards are not thought to be necessary in order to guarantee a "true and fair" view in the accounts. The term "true and fair" is the cornerstone of all UK accounting but is not defined even in the Companies Act 1985. Although there is no statutory definition of the term "true and fair", it is generally held that accounts must be prepared in accordance with "generally accepted accounting principles" (GAAP). It is the accountant, trained within a specific intellectual framework, who is expected to decide on best practice and, in the absence of a specific accounting standard on a subject, how to apply

GAAP and the notion of “true and fair” to a problem. Detailed and prescriptive rules which govern the exact accounting for a specific issue are just not necessary, and may even harm the application of “true and fair” in certain situations. As a result, the UK standard-setting process has historically tended to be less prescriptive, allowing a variety of practices to be adopted to suit the unique nature of the accounting problem. This was especially true in the accounting rules governing tangible fixed assets. Many of the principles for determining the cost of tangible fixed assets when they are initially recognised and measured were thought to be “well known and accepted” (ASB, 1997, p. 117). As a result, prior to 1997, it was thought largely unnecessary to have a dedicated standard outlining the accounting practice for tangible fixed assets.

The large differences and variety in the actual accounting for tangible fixed assets in annual reports prompted a change of opinion by the ASB. Fuelled by public criticism of differing practice by companies, the ASB sought to revise the accounting rules for tangible fixed assets. The ASB discussion paper of October 1997 was unanimous in calling for a specific FRS devoted towards clearing up the issues surrounding the variability in accounting for tangible fixed assets. No longer would selective and infrequent revaluations be tolerated. The reasons behind the accounting agenda for change are clear, but it was only in the actual consultation process itself that property professionals began to offer comments in support of their own interests.

Optional or mandatory revaluation of assets?

For the accountant, financial reports can be prepared on either the historical or modified historical cost basis. The balance sheet can show assets either at historical cost (less any depreciation) or at some current valuation (less any depreciation). It is up to the individual company to decide whether or not to revalue its assets. The Institute of Chartered Accountants in England and Wales defended the status quo:

We are concerned that there is an implication that balance sheets including revalued assets are somehow “better” than those based on historical costs or that they show the true value of the business. We also believe that the ASB should not be seeking to regulate who gets involved in revaluations, rather than leaving this to management to decide what is appropriate (ASB, 1998, p. 278).

This was in stark contrast to the view espoused by the RICS on the same question:

the revaluation of property assets on a regular and consistent basis, of those companies for which property is a material part of their assets, is important information for both shareholders and managers and therefore regular valuations should be a requirement rather than merely optional (ASB, 1998, p. 494).

The different attitudes about the function of the balance sheet for property companies is evident in this direct contradiction. For the accountant, balance sheets are not there to be used as a vehicle for valuing a company; rather they are a stewardship document with which to show that the assets of the company

are still present. However, for the property professionals it does not make sense to include an “out-of-date” historic valuation for property, especially when it does not show the true worth of the asset.

Establishing the initial cost of an asset: capitalisation of interest

The establishment of guidelines governing the initial measurement of an asset’s cost was an area of intense debate and disagreement within both the discussion paper and FRED 17. For the accountants, the main issue was consistent accounting practice across all firms. No longer could “creativity” in the initial measurement of an asset’s cost be tolerated. However, for property professionals, the key issue was for accounting performance to be reported accurately and realistically in all situations. For them, no one set of guidelines could be universally applied to all types of property assets, as each had its own unique nature and complications. This was especially valid with investment properties and the right to capitalise the costs of financing into the cost of the asset.

Differences in the views of the two professions were very clear on the question of the capitalisation of interest costs that were directly attributable to the construction of a tangible fixed asset. Prior to FRS 15, capitalisation of interest as part of the cost of an asset was optional, but debate surrounded making the practice either mandatory or prohibited. The initial view of the ASB discussion paper was that for consistency of reporting, capitalisation of financing costs into the final cost of an asset should be either mandatory or prohibited, though opinion on which was mixed. The prohibition of capitalising interest costs could have immense negative effects on certain company results, at least in the short term. However, making such capitalisation mandatory could also negatively affect the choice of firms, especially where their existing policy was to write off interest costs immediately against profits. Consistency of practice was also a major concern. If a company chose to capitalise financing costs on some assets, then it was thought that it should apply the policy consistently across all the assets it constructed. If it chose not to capitalise, it should never capitalise interest costs on any asset. Within all these issues, opinion was mixed. However, it was immediately clear that the views of the accounting profession directly opposed those of the property professionals.

For the Institute of Chartered Accountants of Scotland the best practice to adopt on capitalisation was very evident:

the present position of “optional” capitalisation of interest is unsatisfactory and, for consistency of reporting, capitalisation of interest should be mandatory where it meets a list of predetermined criteria. The ASB should develop more specific guidelines which identify when capitalisation of interest should be required (ASB, 1998, p. 297).

Arthur Anderson agreed:

We believe that the capitalisation of interest should be made mandatory. We can see no grounds for permitting companies the choice as between whether they do capitalise interest or whether they do not (ASB, 1998, p. 13).

The Chartered Institute of Management Accountants (CIMA) agreed that practice should be consistent across all companies, but suggested that:

As a general principle we believe that the capitalisation of interest costs is unnecessary for a true and fair and should be prohibited (ASB, 1998, p. 152).

The view of the accounting profession was neatly summarised by the Chartered Institute of Public Finance and Accountancy (CIPFA):

We agree with the board that, for the purposes of consistency, it is necessary to decide whether to make capitalisation of interest mandatory or to prohibit it completely (ASB, 1998, p. 156).

However, the views of the property profession were very different to this. The response of Frogmore Estates was typical of the difference in opinion:

I am not convinced that accounting policy regarding the capitalisation of interest need be prescriptive. I should prefer that companies are free to select the policy they judge best suited to their business provided that policy is clearly stated and consistently applied (ASB, 1998, p. 225).

Brixton Estate plc were even more critical of the ASB discussion paper:

The arguments for the capitalisation of interest to be either mandatory or prohibited are not set out in the Discussion paper. No explanation is given as to why the present position of the capitalisation of interest being optional is unsatisfactory . . . it is well known by the users of accounts, particularly investment analysts, which companies capitalise interest and which do not capitalise. Consequently the question of whether interest should or should not be capitalised is not an issue as far as users are concerned (ASB, 1998, p. 111).

The British Property Federation was especially damning of the ASB's role framing the capitalisation debate:

The Federation does not believe that any case has been made for restricting the current options other than perhaps the unconscious belief that is what the ASB is there to do (ASB, 1998, p. 105).

However, it is interesting to note that the Federation's membership were not in unison over the issue: "individual members of the Federation support arguments both for and against [capitalisation]" (ASB, 1998, p. 106).

In total, the responses of the property profession clearly highlight the different terms of reference that property professionals applied to ASB proposals. They simply did not comprehend the problems the ASB faced from the lack of consistency in, and vagaries of, observed capitalisation practice in the UK. For property professionals, as long as accounting policy was disclosed, users of accounts could simply adjust the accounting reports when they had to compare the performance of capitalising and non-capitalising companies. For the accountant, it was clear that allowing the optional capitalisation of interest could lead to inaccurate and confused decision making by users of accounts. Smith (1996) shows that even investment analysts, with the necessary information to hand, do not always adjust for the impact caused by the capitalisation of interest when comparing firms.

The view of Eurohypo Limited, an arranger of finance for property companies in the UK, could be taken as a "middle ground" view:

We are puzzled why the Board [ASB] feels that the existing system does not work satisfactorily. Most property companies capitalise interest cost as they would other inputs to the construction process. So long as the approach adopted by each company is clear from its accounts, the argument for consistency is weak. It is appropriate for the reporting company's board to be accountable for its choice but each board should have that choice (ASB, 1998, p. 224).

To confuse the debate further, ICI, as a neutral "third party", even stated that they were so persuaded by the argument for capitalisation, that they implied that they might change their existing policy:

ICI currently does not capitalise interest and we could be content to continue with this basis. However, we are persuaded by the arguments that the cost of financing the construction is no different from other costs and thus consider it more correct to capitalise. This would produce consistency with purchased assets where finance costs would be included (ASB, 1998, p. 271).

However, this might be viewed more in the light of a need to report higher profitability than a desire for more accurate accounting.

Establishing the initial cost of an asset: cessation of interest capitalisation

The discussion about the *right* to capitalise interest costs was only the starting point of the debate, however, as the next part of the discussions focused on the point at which interest could no longer be capitalised as part of the cost of the asset. For the ASB in FRED 17, it was thought that capitalisation should cease when the construction of the asset had been completed. This view, although appearing trivial, had immense relevance for the property industry where physical completion of an asset did not coincide with the income stream commencing. Representatives of the property profession, such as Brixton Estate plc, once more rallied to their cause and disputed the ASB proposals:

We also do not agree with the statement that capitalisation of the costs of development properties should cease with the end of the construction period. It is considered that a reasonable period to let the property is an integral part of the development process and therefore interest should be capitalised during this period where a company's policy is to capitalise interest (ASB, 1998, p. 112).

British Land moved that the rules should recognise the complexities involved in property development:

The precise cut off time for capitalisation is arbitrary but needs to recognise that the investment appraisal for the development will have allowed a period post practical completion for the property to let if it is not subject to prelet. A usual time period would be something between six months and one year (ASB, 1998, p. 96).

In their response to FRED 17, The Brewers and Licensed Retailers Association argued that the cut off point suggested by the ASB was far too strict:

We agree with this insofar that operating costs should not be capitalised when an asset is available for use. However, we believe that this proposal may be too strict in cases where, for example, it takes time for the asset to become fully operational. It does not seem unreasonable for launch costs and similar marketing expenditure to be capitalised for a limited period following completion of construction, and while the asset is being marketed (ASB, 1999, p. 52).

However, they did acknowledge the problem the ASB faced if it allowed a “variable” cut-off approach:

Whilst we accept that there could be room for abuse if the proposal were relaxed we believe that sufficiently stringent limitations could be laid down to ensure that such abuse could not occur (ASB, 1999, p. 52).

It was precisely such abuses of capitalisation that the ASB was attempting to prevent. During the late 1980s and early 1990s, there were widespread abuses of interest capitalisation in a bid to boost reporting earnings and prop up company performance (for example, see Smith, 1996). Although the Companies Act 1989 allowed capitalisation in “respect of the period of production”, the term was not defined, leading to abuses. One of the most interesting responses was received from the Finance Director of the hotel-owning company Queens Moat, which had abused the rules and over-capitalised interest into the production cost of their assets:

My own company suffered immeasurably from hidden capitalisation of expenses and any rules which swing the pendulum back in favour of capitalisation must be discouraged. I reject the notion that it is unfair on the company undertaking its own developments as opposed to purchasing complete from a third party. The third party does not capitalise all interest just as my own company does not capitalise interest costs of holding stock or collecting debtors (ASB, 1998, p. 484).

For this company it was clear – accounting abuses must stop, even if it appeared unfair on property developers.

With FRS 15, the ASB were attempting to lay down accounting guidelines that fleshed out and clarified the Companies Act rules on capitalisation. For the ASB and most of the accounting profession, consistent and accurate reporting of interest capitalisation was paramount. The effect on the reported profits on property companies seemed to be of secondary concern, at least until the ASB received a number of vocal responses about the issue from property companies. The rise of the “economic consequences” argument was seen here just as much as it was during the discussion of investment property depreciation (developed later).

In its actual germination, FRS 15 allows the optional capitalisation of interest costs according to the following guideline:

Only costs that are directly attributable to bringing the asset into working condition for its intended use should be included. Such costs should be capitalised only for the period in which the activities that are necessary to get the asset ready for use are in progress (ASB, 1999, p. 1).

When the asset is ready for use, further costs are classified as abnormal costs (which are those costs not directly attributable to bringing the asset into working condition for its intended use) and must not be capitalised. The implications for certain property developers are clear – optional but limited capitalisation.

The special treatment of investment properties

Debate also surrounded the discussion concerning the continuance of the special accounting arrangements for investment properties. Investment

properties already had their own specific accounting standard – SSAP 19 Accounting for Investment Properties, which allowed for such assets to be treated differently from other types of tangible fixed assets properties. They were not subject to the requirement for depreciation, and had their own unique rules for valuation. Prior to the issue of the 1997 discussion paper FRED 17 (ASB, 1997), it had been widely thought that the ASB would require property companies to start depreciating investment properties (Brett, 1996). However, in the ASB discussion paper *Measurement of Tangible Fixed Assets* (ASB, 1997), it was only suggested that investment properties should not be treated any differently from other types of property held by a company. Total consistency of valuation practice across all forms of property assets was thus presented as an accounting option. Investment properties would be depreciated just like any other type of property. For some sections of the accounting profession, this proposal was seen as conceptually valid, as evidenced by the ICAEW (ASB, 1998, p. 284):

Intellectually, there appears to be little justification for continuing to treat investment properties differently from other properties. We believe the arguments for not depreciating investment properties therefore need to be examined carefully and a stronger case should be made if such properties are to continue to be exempt from depreciation.

However, other representatives of the accounting profession preferred the non-depreciation route, as long as revaluations were conducted each year. The general consensus was that the current arrangements were working well because there was no demand from users of accounts for investment properties to be depreciated. It seems that lack of user demand outweighed any need for consistency in accounting practice across all types of property. With this in mind, it is surprising that the ASB members of the board even suggested that investment properties should be depreciated. It must be concluded that the ICAEW are a powerful voice on the board of the ASB.

Liberty International plc agreed with the notion that investment properties depreciate. However it put forward a view that the subsequent accounting for such depreciation was virtually worthless:

We agree with the principle that investment properties depreciate. However, given the weight of prescriptive accounting regulation that has been put in place in recent years, the ASB should be very wary of pursuing accounting solutions which are intellectually elegant but which totally ignore the practicalities of implementation. There is little point enforcing a prescriptive treatment if the underlying processes are so subjective that the results are of little or no incremental value to the users of the accounts (ASB, 1998, p. 122).

However, in general, and unsurprisingly given the apparent views of users of accounts, the property industry strongly disagreed with the professional accounting view of the ICAEW. British Land Company plc illustrated the economic consequences of such revisions to the accounting requirements:

We firmly believe both that depreciation of investment properties is intellectually untenable and that the practical consequences would be severe (ASB, 1998, p. 97).

The proposal that investment properties should be depreciated fails to distinguish the significant characteristics of the commercial operations of property investment in the UK. Specifically, there is an assumption that investment properties have the same physical character as plant and machinery without recognition of the effect of the institutional lease. The institutional lease creates a hybrid asset with the characteristics both of bricks and mortar and also of a financial instrument. From the point of view of property companies, the depreciation proposal, by threatening to make it impossible to pay dividends out of current income, brings the argument to a head (ASB, 1998, p. 98).

Interestingly, this is one of the few responses, even from property professionals, which directly addresses the negative consequences of charging depreciation on investment properties. This is surprising. The increased prominence of “economic consequences” within debates surrounding development in accounting standards is nothing new, as has been highlighted by Zeff (1978, p. 9):

The increasing involvement of “non-professionals” in the standard setting process, and the economic (and social) consequences of the accounting standards themselves are inextricably related. The very intervention by outside parties in the setting of standards appears to be due, in large measure, to their belief in the fact of economic consequences.

Clearly, for the majority of accountants, only one profession, namely the accounting profession, has a right ultimately to control the direction of the standard setting process. Quite obviously, the ASB and the accounting profession has to be seen to be in charge of its own area of expertise, but must also be seen to balance this with the interests and views of what Zeff (1978) classifies as “non-professionals”. However, what happens when these “non-professionals” are themselves a professional group, with an expertise and established methodology for the valuation of property assets? In the case of FRS 15, valuers had already established an alternative body of knowledge and codified procedure for dealing with many of those issues under consideration by the ASB. Property professionals value buildings as their major function; accountants do not. Through their training, property professionals understand the unique nature of the property valuation problem; accountants can never claim this. Accountants have typically viewed all tangible fixed assets as identical problems that need to be accounted for in a consistent and logical manner. Could the intellectual framework possessed by the property profession, and utilised for the financial and managerial benefit of its clients, be viewed on an equal footing with that of the accounting profession?

With FRS 15, the ASB was faced with a dilemma requiring a delicate balancing of accounting and non-accounting variables. The finished standard should be seen to rest chiefly on accounting considerations, but must also at least be seen to study the possible adverse economic consequences of its proposed actions. These so-called non-accounting variables were made very clear during the consultation process, as the accounting profession faced extremely vocal representations from both property companies and property professionals worried about the economic consequences of the new accounting standard. This issue was particularly problematic for the ASB, especially

because another profession could also claim to have established accepted “accounting” variables on the valuation of assets. The accounting profession did not have a clean slate to work with, because the property profession had established concepts of “value” in place and in everyday practice. Were they to construct new notions of “value”, they would be open to criticism from an influential group of professionals; if they did not, then it might appear that they were being told how to account for an accounting issue. Such a problem is not one that the UK accounting profession has to deal with often.

This issue was not straightforward, however, because the property profession did not universally endorse the same intellectual conceptualisation on the issue. The economic consequences argument, surprisingly, was not put forward by any of the professional property institutions. The RICS disagreed with the views of the ICAEW, claiming that the established accounting arrangements should be maintained, and such properties should be exempt from the need to charge depreciation. However, their comments did not mention the negative consequences of any accounting changes:

The Institution agrees that investment properties should continue to benefit from SSAP 19 [and be exempt from depreciation charges] (ASB, 1998c, p. 496).

The reasons for the view expressed by property professionals were clearly explained by Brixton Estate plc:

Investment properties are in effect property investments which are no different from other investments, e.g. shares and bonds, and accordingly should be treated in the same way. They are not tangible fixed assets in the sense that they are required for the purposes of a business and used by a business for the purpose of providing a service or manufacturing products. As the economic rationale for holding such properties is more that of an investor rather than a manufacturer or provider of service it follows that investment properties should be accounted for in the same way as investments [and not be subject to depreciation] (ASB, 1998, p. 112).

After the first discussion paper, the issue of investment properties and their depreciation was dropped from the proposals of both FRED 17 and FRS 15, and remained accounted for under SSAP 19. The property profession had obtained a substantial victory in the consultation.

Depreciation of property assets

Another area for discussion involved the depreciation of long-lived assets, such as property (excluding investment property). It was the contention of the ASB that all property had a finite economic useful life, regardless of maintenance expenditure and management. This was a major change. Prior to the FRS 15 discussion process, a number of companies did not depreciate their tangible fixed assets, on the basis that either the residual value will be maintained, or the useful economic life extended for a significant period because maintenance or refurbishment is carried out regularly. The ASB did not support this view and made it clear in both the discussion document and in FRED 17. Most surprising was the lack of discussion over the issue, coupled with the lack of any organised objection from the property profession. Whilst there was a wealth of negative feeling towards any proposal to charge depreciation on

investment properties, very little was said about depreciation on owner-occupied property. One of the few responses was from Granada, which urged that some types of assets should not be depreciated:

Whilst we agree that most assets will have finite useful economic lives despite maintenance and refurbishment spend, we believe that certain hotels assets, particularly those in historical buildings such as The Waldorf Hotel in London, do in fact increase in value when properly maintained (ASB, 1998, p. 235).

Certainly, this idea was supported by the RICS:

Provision for depreciation is not appropriate for antiques and fine art [that may or not be part of a building], classes of which, given reasonable care, can have infinite life (ASB, 1998, p. 496).

However, besides these two responses, there was a lack of interest in the issue. This is all the more surprising given the impact such depreciation could have on the reported profitability of companies with substantial property assets.

Acceptance of the proposals is a surprising anomaly, particularly in terms of the lack of ferocity and the number of responses to the consultation. FRS 15 now states that, apart from non-depreciable land, the only ground for not charging depreciation on a tangible fixed asset is that the depreciation charge is not material, owing to a long estimated remaining useful economic life or high residual value. Where depreciation is not charged, however, impairment reviews are to be undertaken at the end of each reporting period. The ASB was clearly successful in retaining this proposal throughout the consultation.

Valuation and property type methodology

The ASB discussion paper included RICS definitions of both valuation approaches and types of property. No real comment was made on their appropriateness to the accounting problem under consideration, and the conceptual framework was proposed in its entirety. Obviously, the RICS were supportive of their use:

The Institution endorses the proposals [for determining valuation] as they conform with some of the provisions of PS 7.10.2 in its Appraisal and Valuation Manual. However, the Board may like to consider adopting all of the requirements laid out in this part of the Practice Statement, and *together* [emphasis added] with the Institution, consider whether it is desirable to require that where more than one basis of valuation is used there should be disclosure of the total valuation of properties on each basis. This would be particularly relevant where the depreciated replacement cost basis is used as it is so materially different from market based measures (ASB, 1998, p. 495).

What is especially interesting is the use of the term “together” in the quote. The property profession is in this issue establishing its own intellectual gestalt into one of the key aspects of an accounting standard. The RICS has effectively established how accountants are to account for property. Additionally, no disagreement for the use of the RICS definitions was made by any of the accounting professional bodies, which appears to be very surprising. Here can be witnessed a major concession gained by the property profession, and a most successful conclusion for the profession to the consultation process. This is not a joint agreement between the ASB and the RICS (such as the 1974 proposals) but an acceptance of the RICS’ approach to value.

Conclusion

Through its various discourses, the property profession as a whole played an important role in establishing FRS 15. Whilst the full intellectual implications from an accounting conceptual framework were not always appreciated, some aspects of the consultation were greatly influenced by property professionals. Whilst the profession did not always understand the “pure” accounting problems, they did have a firm grasp on valuation as a concept and the economic consequences of its application to property. Without the representations from it, FRS 15 might have been a very different beast indeed. However, it is still clear that, compared with the number of businesses that own and lease property and the professionals who advise them, few actually involved themselves with the process that has had, and will continue to have, such serious financial implications for the way in which property is owned and managed.

This paper has outlined the roles played by the accounting and property professions in drawing up the Standard. It did this by looking at some of the most interesting debates, which either resulted in potential “economic consequences” for property companies or involved concepts and issues already established in the vocabulary and knowledge base of the property profession. As was seen, the accountants and the property professions had sometimes similar and sometimes differing ambitions for FRS 15. The end result was a compromise brought out through a complex interplay of views, opinions and professional knowledge. FRS 15 arose from the interplay between this “constellation” of forces in a manner similar to that described by Burchell *et al.* (1985). It seems unlikely that FRS 15 will be the final act in defining accounting for tangible fixed assets: the ASB has yet to revise either the standard governing investment properties or lease-held property. The time may come for further revisions in the accounting for property assets and the battle between the professions may resume once again. In such an event, it is important that the property manager notes both the intellectual concepts involved and the pragmatic issues specific to property management.

Notes

1. It should be noted that this paper is simply examining the technical aspects of these two disciplines, and the implications upon property management. An analysis of the implications within the context of the sociology of the professions is necessarily omitted here due to the considerations of space.
2. In fact, the option to carry certain types of fixed assets at an accounting valuation above historic cost was first granted by the Companies Act 1948.
3. In May 1990 the predecessor to the ASB, the Accounting Standards Committee (ASC) had made the first abortive attempt to establish detailed rules surrounding the valuation of tangible fixed assets through the issuance of Exposure Draft (ED) 51: Accounting for Fixed Assets and Revaluations. However, in August 1990, following continual criticism, the ASC was disbanded and replaced by the ASB. One of the ASB’s first actions was to abandon ED 51. No other work on tangible fixed assets was conducted until the 1993 ASB discussion paper.

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