

Valuation Guidance for Cultural and Heritage Assets

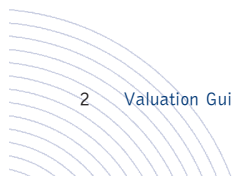
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1 – Introduction

1.1 Purpose

The purpose of this document is to provide practical guidance on the valuation of heritage and cultural assets in the context of New Zealand general purpose financial reporting, so as to facilitate a consistent and cost effective approach across the public sector. The guidelines set out in this document are expected to be referenced to in the Treasury Instructions and are intended to be applied by departments.

At the moment, libraries are using the draft guidance on valuation of library collections that was jointly issued by the Library Association of New Zealand, the National Library and Audit New Zealand in 1992. This guidance replaces that previous guidance and reflects changes resulting from the introduction of FRS-3 *Accounting for Property, Plant and Equipment*. The scope of the guidance has been extended to cover other heritage and cultural assets in addition to library collections.

1.2 Scope

Heritage and cultural assets are those assets that are held for the duration of their physical lives because of their unique cultural, historical, geographical, scientific, and/or environmental attributes. They assist holders of the assets to meet their objectives in regard to exhibition, education, research and preservation, all of which are directed at providing a cultural service to the community.

In the context of this proposal, cultural and heritage assets include, but are not limited to:

- general collections in libraries;
- heritage collections in libraries;
- museum collections (such as those in Te Papa);
- art gallery collections;
- historical documents, historical monuments and heritage assets held in local authority trusts.

1.3 Summary of the Proposed Approach

FRS-3 encourages entities to revalue their property, plant and equipment (PPE), and where they do so, requires them to use fair value.

If an entity has decided to revalue its cultural and heritage collections, it should follow the following procedure to determine the fair value of an asset:

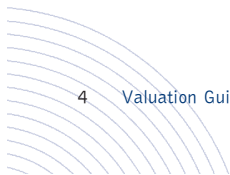
- a If an active market exists for the same asset or a similar asset, the market prices are deemed to be the fair value; or
- b If there is no active market, fair value should be determined by using other market-based evidence; or
- c If there is no market-based evidence, use Depreciated Replacement Cost (DRC).
For practical purposes, where an asset has an indefinite or sufficiently long life, no depreciation charge should be applied.

1.4 Changes from the Current Practice

The previous draft guidance issued by Library Association, National Library and Audit New Zealand requires using DRC to value current use collections every three years. Net market value is used to value “permanently retained” collections with items of high value being assessed individually. Given the intention to retain them permanently, they are not depreciated.

The proposed approach has incorporated the changes introduced by FRS-3 and moved away from the distinction between current use collections and “permanently retained” collections for valuation purposes. Regardless of asset classifications, all assets are valued first by referring to market prices or market-based evidence, and DRC is used only when the market information is not available.

When using the DRC approach and applying depreciation, exception is made for assets that have indefinite or sufficiently long useful lives. The depreciation amount for such assets is considered irrelevant or negligible, therefore no depreciation is charged against them.



1.5 Rationale for Valuation

Financial reporting of cultural and heritage assets is useful for three reasons:

- Accountability – to provide information by which the Chief Executive Officer and governing body can be held responsible for their stewardship of public assets and to measure changes in the net worth of public sector entities over time;
- Management decision making – to provide management with the information required to manage effectively the assets under their control and to make appropriate decisions on their utilisation and the future allocation of resources to them; and
- Insurance – the valuations obtained for financial reporting have relevance for decisions regarding insurance and risk management purposes.

In addition, Members of Parliament, Councillors, the public or ratepayers are entitled to know the extent of the resources that have been allocated by the central or local Government to the cultural institutions.

The valuation of cultural and heritage assets will provide information to management and/or the public to allow them to:

- have a complete picture of the financial value of the assets at a particular time;
- make comparisons of changes in the financial value of the assets over time;
- allocate new funds between different types of assets;
- re-allocate resources to higher priority assets through the sale of existing low priority assets; and
- develop appropriate internal management practices and procedures.

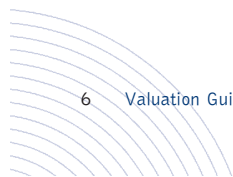
To best achieve these purposes the financial information provided should be current. If an historical cost approach is used, no account is taken of specific or general price movements since purchase, comparability between financial statements is reduced and distortions may be introduced as to the value of components of the collections assets.

As noted in paragraph 1.3, FRS-3 encourages but does not require reporting entities to revalue cultural and heritage assets. Underlying this view is the proposition that fair value, the value for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction, represents the best estimate of the intrinsic cultural or heritage value of the assets.



In determining whether or not to revalue, and the frequency of revaluations, entities must trade off the benefits noted above with the costs associated with the revaluation. Where the entity is consolidated into the Crown's Financial Statements, another factor will be the usefulness of consistency with the Crown's accounting policies.

This guidance has been prepared for the users of entities that have decided to revalue their cultural and heritage assets.



2 – Accounting Framework

2.1 The New Standard: FRS-3

FRS-3 *Accounting for Property, Plant and Equipment* covers all property, plant and equipment (PPE) and applies to periods ending on or after 31 March 2002. It replaces SSAP-3 *Accounting for Depreciation* and SSAP-28 *Accounting for Fixed Assets*, although SSAP-3 remains on issue to cover the amortisation of intangible assets.

Major changes introduced by FRS-3 are the prohibition of capitalising feasibility costs, the introduction of component accounting for items of PPE and the use of fair value when revaluing.

2.2 How Does FRS-3 Apply?

The *Statement of Concepts* defines an asset as having three essential characteristics:

- there must be service potential or future economic benefits;
- the entity must have control over the service potential to the extent that the entity is able to enjoy the benefits, and deny or regulate the access of others to the benefits; and
- the transaction or other event that gives rise to the entity's control must have occurred.

Furthermore, under FRS-3, *Property, Plant and Equipment* are tangible assets that:

- are held by an entity for use in the production or supply of goods and services, for rental to others or for administrative purposes, and may include items held for the maintenance or repair of such assets; and
- have been acquired or constructed with the intention of being used on a continuing basis.

As cultural and heritage assets are for the continuing use of the library, museum, art galleries and other entities in the provision of services to the community, they are within the definition of PPE. It would be inappropriate to write off investments in cultural assets as a current expense, when the economic benefits will mainly emerge in the future.

FRS-3 requires all cultural and heritage assets (including collection assets) that meet the definition of PPE and can be reliably measured, to be recognised in the entity's financial statements.

2.3 Fair Value

Cultural and heritage assets are to be valued on the same basis as other physical non-current assets of an entity. FRS-3 permits subsequent revaluations of these assets, provided that fair value is used.

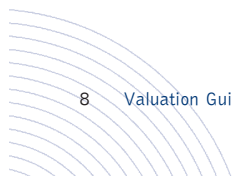
'Fair Value' is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Other terms commonly used to describe 'Fair Value' include 'Market Value', 'Open Market Value' and 'Current Market Value' (FRS-3 paragraphs 4.23 and 4.24).

Fair value is considered to be the most appropriate basis of valuation because it represents the exchange value of the future economic benefits embodied in the asset regardless of the manner in which the entity has chosen to utilise the asset (FRS-3 paragraph 7.3).

Where the fair value of an asset can be determined by reference to the price in an active market for the same asset or a similar asset, the fair value of the asset is determined using this information. Where the fair value of an asset is not able to be determined in this manner, it should be determined using other market-based evidence (FRS-3 paragraph 4.26).

Where the fair value of an asset is not able to be reliably determined using market-based evidence, Depreciated Replacement Cost (or DRC) is an acceptable estimate of the fair value of an asset (adapted from FRS-3 paragraph 4.11). DRC is based on the reproduction cost of a specific asset. In principle, it reflects the service potential embodied in the asset.

One concern that has been expressed with this approach is that where the majority of the collection is either purchased from overseas, or the New Zealand prices vary with foreign exchange rates, the foreign exchange rate fluctuations could adversely impact the valuation. It is recommended that where the exchange rates are an important factor in the valuation, disclosure be made of the exchange rate assumptions used in the notes to the accounts.





3 – Key Valuation Judgments for Collection Assets

There are a number of critical valuation judgments that impact on a valuation. These judgments are likely to be most effectively made through a collaborative approach involving collection managers, curatorial staff, valuers and finance officers.¹ We suggest that these judgments be discussed with auditors before the valuation process begins. It is usually possible to develop a process that meets the goals set for the project, while remaining cost effective. The planning and conduct of a valuation project is discussed later in this paper.

3.1 Identification and Classification of the Assets

Identification is the first step in establishing whether an item is an asset that can be reliably measured. The management of libraries and museums is orientated towards collections and therefore valuation should proceed based on collections.

There are three approaches in identifying individual collections: collections may be grouped by broad subject, by audience or by format.² Most entities use a mixture of all three approaches. It is recommended that entities adopt a pragmatic approach in grouping the collections, and try to identify as few collections as possible.³ Record-keeping systems should be able to provide information on the number of items in each collection.

In identifying collections it may be found that some of the components (i.e. current awareness bulletins) are effectively consumed within the financial year in which they are purchased. In such cases, it would be appropriate to expense these items immediately rather than record them as part of a fixed asset.⁴

Where the valuer is required to exercise professional judgement to determine the most appropriate classification, the determination and its basis must be fully disclosed in the valuation report by the valuer.

1 *Guidelines on Accounting Policy for Valuation of Cultural Collection Assets*, June 1998, Heads of Treasuries Accounting and Reporting Advisory Committee, Australia.

2 *The Valuation of Library Collections - A Proposal*, page 4.

3 *Ibid*, page 4.

4 *Ibid*, page 4.

3.2 Valuing Individual Items or Groupings of Similar Assets

When assessing the need to value a collection of items that are perceived to be of low monetary value individually, regard should be given to the potential value of the overall collection before making any decision not to undertake a valuation. For example, minerals, invertebrate palaeontology, and invertebrate zoology collections may frequently hold large numbers of items that are of low value individually but the value may be material when each collection is considered as a whole.

A collection that comprises a complete set of all known specimens may have a value that is greater than the sum of the values of the individual items. In other words, there is a premium on the completeness or comprehensiveness of the set of specimens. Where such a situation exists, the group of items should be valued as a whole.

3.3 Measurement of the Assets

The measurement basis for each grouping or classification needs to be determined. When revaluing heritage and cultural collections, the choice is between fair value, depreciated replacement cost or ascribing no financial value to the item.

3.3.1 Fair Value

To use fair value in measurement, the first step is to determine whether there is an active market for such assets. In determining the availability of such a market, it is important to consider the function of the asset. It may be possible to replace the function of an asset not with an identical asset but with another type of asset. Therefore, the absence of an active secondary market for a particular type of asset does not necessarily mean that it cannot be measured reliably. Where the fair value of an asset can be determined by reference to the price in an active market for the same asset or a similar asset, the fair value of the asset is determined using this information.

Where fair value of the asset is not to be determined in this manner, the fair value of the asset is determined using other market-based evidence, such as recent auction prices and dealer catalogues.



Only in cases where fair value of the asset is not able to be reliably determined because of the absence of market-based evidence should DRC be considered as a proxy for determining of the fair value of collections.

3.3.2 Depreciated Replacement Cost (DRC)

FRS-3 regards DRC to be the most appropriate basis for determination of fair value where fair value of the asset is not able to be reliably determined using market-based evidence (paragraph 4.26).

The specialised or unique nature of certain assets means there may not be a market available. In such cases, the appropriate value is DRC. For example, for specimens, the cost of mounting an expedition or field trip to re-collect the same specimens, together with the costs associated with their documentation and preparation represent the replacement cost for accounting purposes.

The purpose for which the items are held will determine the appropriate form of replacement and thus valuation. For instance, an asset may represent a certain school of art, the clothes of a particular historical person, or an example of pre-war film production. It may be possible to replace the function that a unique item performs by the acquisition of another painting of that school, some other possessions of the historical character or a copy of another film of that period by a different producer. However, if the painting was held because it was by a particular artist, or because the clothes had been worn by a famous fashion model, or the film had been collected because it was the work of a particular producer, the replacement items used as a reference for valuation must relate to those specific persons.

Further, as an example, a library may hold a set of encyclopaedias. If the set is held for its information content, then the cost of a CD ROM may be the measure of its replacement cost. If it was held for its binding or printing techniques, then a CD ROM would not be an appropriate substitute. It is important, therefore, for the collection managers to decide on the form or manner in which an asset would be used (having regard to its functions), and to advise the valuer accordingly.



3.3.3 Unrealisable, Irreplaceable Items

Reliable measurement using either fair value or DRC may be difficult for certain groups of items including:

- unique items that have iconic status (e.g. the Treaty of Waitangi);
- historic and irreplaceable library and museum collections; and
- items that are sacred to particular communities.

It is suggested that valuers should try to ascribe a financial value to these assets, on the basis of similar assets or the highest and best use of the assets – i.e. using the best estimates. Only in the case where it is impossible to do so will no financial information be ascribed to the assets. In such case, relevant information on those items should be disclosed in the notes to the financial statements. The note should include the reasons for the inability to obtain a reliable value, the quantum, nature and functions of the assets and their heritage significance, together with an estimate of the annual cost of maintenance/preservation, where applicable. It is emphasised here that describing these assets in notes does not mean that they have no value, rather it is not possible to assess what the asset would realise if it was sold and it is not able to be replaced.

3.4 Depreciation

FRS-3 requires that depreciation of a PPE asset be charged over the asset's useful life (paragraph 8.1). The underpinning rationale is that the economic benefits embodied in an asset are consumed by the entity, therefore the carrying amount of the item should be reduced to reflect this consumption (paragraph 8.2).

Depreciation should be regularly reassessed. For example, if the library's policy moves towards making increasing use of electronic resources to which the libraries lease access, this may signal a shortening of the useful life of the 'hard copy' resources.

Some assets such as art works and museum collections have very long useful lives. For such collections, the rate of deterioration is reduced to such an extent through proper care and conservation that it may be regarded as negligible. Therefore no depreciation (or zero depreciation) should be charged, as for practical purposes, there has been no consumption of the asset in the reporting period. Assets that fall into such a category would need to have their useful life assessed and that life would need to be sufficiently long to render depreciation negligible, and be revalued regularly. However, this should



not be construed as allowing a blanket exemption from depreciation. Library current use collections and museum working models do get consumed and must be depreciated.

3.5 Revaluation Frequency

The frequency of revaluations will need to be determined by the reporting entity.

FRS-3 requires that where assets are revalued, such revaluations occur on a systematic basis, at a minimum of every five years.

It should be noted that there is an override to the five-year maximum revaluation frequency – i.e. that revaluations are undertaken with sufficient regularity to ensure that no cultural and heritage item is included at a valuation materially different to its fair value.





4 – Carrying out a Valuation for Collection Assets

4.1 Planning a Valuation

Having regard to the budgetary constraints and other competing priorities, it is necessary for an entity to plan the valuation process to ensure that it:

- meets the strategic objectives and priorities of the agency in terms of the management of the collection assets;
- places a minimal demand on the finances and other resources of the agency; and
- is acceptable to the auditor for financial reporting purposes.

A collaborative approach involving collection managers, curatorial staff, valuers, finance officers and auditors is the most effective way of planning a valuation. Issues for consideration in the planning process include determining the categories of collections (e.g. European Art), the types of collections (e.g. cultural collections, research material, etc) and the locations of collections as well as identifying collections that cannot be replaced (e.g. extinct flora and fauna) and determining items of known high value. The other key valuation judgments described in the previous section also need to be agreed at the planning stage.

Having regard to the extent and diversity of most entities collections, valuation of appropriate samples and extrapolation of the values obtained to the overall collection is considered to be the most cost effective means of providing the valuations necessary for financial reporting purposes.

Information regarding the categories, types and locations of collection assets and the high value items is required in developing the sampling methodology.

4.2 Independent Valuers

FRS 3 requires that valuation should be conducted either:

- by an independent valuer; or

- where an entity has in its employ a person sufficiently experienced to conduct a valuation, by that person, so long as the basis of valuation has been subject to review by an independent valuer.

Independent valuers are to hold a relevant professional qualification and have experience in the category of collections being valued (FRS 3 paragraph 7.6).

Employees sufficiently experienced to conduct valuations are those who possess expert knowledge and experience in the category of collections being valued. The basis, methodology and assumptions underpinning valuations conducted by such experienced employees are to be reviewed by independent valuers to ensure the appropriateness of the valuation approach (FRS 3 paragraph 7.7).

The requirement of using external valuers may prove to be difficult in the case of valuing cultural and heritage collections, as there are few independent valuers for such collections. The expertise might reside within the entities themselves. If an in-house valuation is conducted, the basis, methodology and assumptions underpinning the valuation should be checked by independent valuers.

4.3 Sampling Methodology

The objective of the valuation exercise is to obtain a valuation which is materially accurate but at a reasonable cost. This may be achieved by selecting the high value items for individual valuation, with the remainder of the collection assets being subject to a sampling methodology. Threshold values will need to be developed for this purpose. Assets above the thresholds would be valued individually, whilst assets below the thresholds would be sampled on a random or other basis for valuation.

The sampling exercise requires technical expertise and involves a number of steps including determining the sample size, selecting the sample, drawing the sample, valuing the sample and calculating the total extrapolated asset value. Sampling will have regard to location and manner of storage, the homogeneity of the items within the collection and the expected range of values within the population to be sampled.

To ensure a high level of statistical accuracy, the sample needs to be representative of the whole population. Therefore, if the collection is not completely homogenous, it will be necessary to stratify the population for sampling purposes to ensure that the sample chosen is truly representative of the whole population. This is commonly known as “stratified sampling”. It normally requires the subdivision of the collection assets into a number of groups and sub-groups. A separate sample is then taken from



each sub-group. Within each sub-group, items should be approximately similar in nature, value and the way they are stored. There should be as little variation in characteristics as possible within each sub-group.

Once the samples have been valued, it will be possible to extrapolate the values applied to the samples to the whole population and calculate the degree of accuracy that has been achieved. The degree of accuracy will need to be considered carefully as it is important to ensure that the valuation is acceptable for financial reporting purposes. If doubt exists over the acceptability of the valuation because of the degree of accuracy, the entity should consult its auditor. In these circumstances, entities would need to weigh up the cost of increasing the sample size against the extra degree of accuracy obtained. Detailed information should be kept of the selection and valuation of samples.

