NHSScotland

Capital Accounting Manual

2014-15

December 2014

Contents

1. Introduction

1.1 Purpose of the Manual

1.1.1 The NHS Scotland Capital Accounting Manual (CAM) replaces the CAM that was last issued in December 2013. It is intended to complement the Financial Reporting Manual (FReM) issued by HM Treasury and the Scottish Capital Investment Manual (SCIM).

1.1.2 The CAM interprets the accounting guidance contained in the FReM and is intended as general guidance on the application of accounting standards and practice to capital accounting transactions in the NHS. It also reflects elements of HM Treasury Consolidated Budgeting Guidance that relate to how expenditure is charged in NHS Scotland accounts.

1.1.3 The CAM will assist in ensuring Annual Accounts are properly prepared according to the FReM. For these purposes NHSScotland bodies should follow the treatment prescribed for departments or agencies except where indicated otherwise in this manual.

1.1.4 It should be recognised that, where the CAM provides general guidance, each individual Health Board must determine that the accounting treatment for all reported financial transactions is appropriate and consistent with current IFRS policy and Treasury Guidance in relation to the capitalisation of expenditure and the impact of demolition and valuation and impairment.

1.1.5 The CAM provides technical accounting guidance rather than specific Scottish Government Directives covered by circular (e.g. MELs, HDLs, CELs or the Scottish Public Finance Manual).

1.1.6 In line with previous versions of the CAM, this edition provides the service with relevant guidance in relation to capital accounting.

1.2 The CAM 2014-15 Edition

1.2.1 This edition supersedes the CAM issued in December 2013. The new edition incorporates:

- Addition of "Loss or damage resulting from normal business operations" under 6.13.5 Categories of impairment.
- Section 12.9.2 – 12.9.5 Recognition of the asset revised to reflect NPD and hub DBFM projects.
- Addition of section 12.8.5 on Design Fee Guidance on Hub Projects.

1.3 Queries and Contacts

1.3.1 For technical guidance and enquiries contact –

Steven Hanlon
Capital Finance and Policy Manager
Scottish Government
Capital and Facilities
Basement Rear
St Andrew's House,
Regent Road
EDINBURGH EH1 3DG
0131 244 2139
e-mail – steven.hanlon@scotland.gsi.gov.uk

2. Recognition and Initial Measurement of Property, Plant and Equipment

2.1 Introduction

2.1.1 In the NHS, problem areas around valuation stem from:

- the fact that much of the NHS estate consists of specialised healthcare assets for which no true market exists;
- the use of a fair value basis of valuation;
- the existence of assets in the form of streams of future income or cost reduction, generated in the course of PFI schemes; and
- the importance of the finance/operating lease distinction because of the operation of Revenue and Capital Resource Limits and the implications of on and off-balance sheet items.

2.1.2 Chapter 7 deals specifically with assets held for disposal (surplus assets).

2.1.3 Chapter 8 deals specifically with leases.

2.1.4 Chapter 12 deals specifically with PFI schemes and the Hub initiative.

2.2 General principles and definitions

2.2.1 Assets are defined in paragraph 49(a) of the International Accounting Standards Board's Framework for the preparation and presentation of financial statements (the 'Framework') as "...a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity".

2.2.2 As a minimum, Boards should analyse their property, plant and equipment under the following headings, distinguishing between owned and leased assets.

- information technology – hardware used for processing data and communications;
- land – any land holdings and land underlying buildings (see below – land underlying or associated with dwellings to be separately disclosed);
- buildings excluding dwellings – offices, warehouses, hospitals, surgeries and multi-storey car parks, etc. Any underlying and associated land to be disclosed separately as noted above;
- dwellings – buildings used entirely or primarily as residences, including any associated structures such as garages and parking areas. Any underlying and associated land, such as gardens and yards, to be separately disclosed;
- infrastructure assets – underlying and associated land should be included;
- transport equipment – equipment for moving people and/or objects, for example cars, lorries, vehicles, ambulances and aircraft;
- plant and machinery – plant and machinery not covered by other categories, including scientific aids and logistics equipment;

- furniture and fittings – office fittings, furniture, showcases, shelving etc.; and
- payments on account and assets under construction – assets currently being built and not yet in use.

2.2.3 The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if: (a) it is probable that future economic benefits associated with the item will flow to the entity; and (b) the cost of the item can be measured reliably.

2.2.4 In this context, 'future economic benefits' means that the asset will contribute in some way to the provision of services or other outputs by NHS bodies. 'Control' in this context means the ability to obtain those benefits in fulfilment of aims and objectives of the entity and to restrict the access of others.

2.2.5 Access to economic benefits can be obtained in various ways. Usually it is obtained by ownership of goods. Sometimes similar access to economic benefits may be obtained without legal ownership, for example where goods are leased by way of a finance lease. In these circumstances, the asset may be barely distinguishable in terms of financial commitment and opportunity for 'risk and reward' from that obtained through legal title. Therefore the accounts should reflect the commercial substance of the transaction. Substance over form and application of IAS 17 Leases, SIC 15 Operating Leases – Incentives, SIC 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease, IFRIC 4 Determining whether an Arrangement contains a Lease, and IFRIC 12 Service Concession Arrangements are dealt with more fully in Chapter 6 of the FReM.

2.3 Property, plant and equipment

2.3.1 IAS 16 Property, plant and equipment applies as adapted retrospectively to accounting periods beginning on or after 1 April 2009. In accordance with IAS 16 property, plant and equipment are tangible items that: (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) are expected to be used during more than one period.

Property, plant and equipment will therefore have physical substance and will have an expected useful economic life in excess of one year when newly acquired.

2.4 Initial Measurement

2.4.1 In accordance with IAS 16, all property, plant and equipment must initially be measured at cost which should also reflect its fair value provided that the transactions are at arms length and no impermissible costs have been capitalised.

2.4.2 Cost is defined as "...the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its

acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, for example, IFRS 2 Share-based Payment". Other consideration could, for example, include an asset given up in exchange.

2.4.3 The cost of an item of property, plant and equipment comprises:

- The purchase price, including import duties and non-refundable purchase taxes less any trade discounts and rebates;
- Directly attributable costs of bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and
- The initial estimate of costs of dismantling and removing the item and restoring the site on which it is located ('decommissioning costs') where there is a corresponding obligation recognised as a provision under IAS 37, 'Provisions, contingent assets and contingent liabilities'.

2.4.4 Subject to *de minimis* limits (see section 2.6 below), all directly attributable expenditure on the acquisition or creation of property, plant and equipment should be capitalised on an accruals basis.

Typically expenditure on property, plant and equipment will involve:

- acquisition, construction, preparation or replacement of buildings and other structures and their associated fixtures and fittings
- acquisition, installation or replacement of movable or fixed plant, machinery, vehicles and vessels

In addition to the direct costs of purchase or construction other directly attributable expenditure that should be capitalised will include:

- Acquisition costs (such as stamp duty, import duties and non refundable purchase taxes);
- Reclamation or laying out of land;
- Site preparation and clearance;
- Initial delivery and handling costs;
- Installation and assembly costs;
- Professional fees (such as legal, architects' and engineers' fees); and
- The costs of employee benefits as defined in IAS 19, 'Employee Benefits', that arise directly from the construction or acquisition of the item.

Only the costs that are 'directly attributable' to the item of property, plant and equipment, and not the general operating costs, may be capitalised. Examples of costs that are not 'directly attributable' are as follows:

- Costs of opening a new facility;
- Costs of introducing a new product or service (including costs of advertising and promotional activities);
- Costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
- Administration and other general overheads.

2.4.5 IAS 16 allows capitalisation of costs only in respect of the period in which the activities necessary to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended by management are being undertaken. Thus, capitalisation should cease when substantially all the activities necessary to get the asset ready for use are complete, even if the asset has not yet been brought into use. 'Ready for use' means when the physical construction of the asset is complete even though routine administrative work might still continue. For example, if minor decoration of a property to a Board's specification is all that is outstanding this indicates that the asset is substantially complete.

2.5 Subsequent expenditure

2.5.1 Once an item of property, plant and equipment has been recognised and capitalised in the books, a Board may incur further costs on that asset at a later date.

2.5.2 Subsequent expenditure should be capitalised, that is recognised as an asset, only if it meets the recognition criteria in IAS 16. As explained above these are that:

- It is probable that future economic benefits associated with the item will flow to the entity; and
- The cost of the item can be measured reliably.

All other subsequent costs should be recognised as an expense in the period in which they are incurred.

2.5.3 Often it is easy to tell whether expenditure is capital or revenue in nature and, therefore, whether it should be capitalised or expensed. For example, the cost of adding a new wing to a hospital should be capitalised as it will meet the recognition criteria of IAS 16. The additional wing contributes to the provision of services of the Board so it is probable that future economic benefits will arise and the cost can be reliably measured. Similarly, the cost of cleaning the hospital, is a period cost of servicing the hospital and should be expensed as incurred.

2.5.4 However, sometimes it is difficult to distinguish whether expenditure on improvements and repairs should be capitalised or expensed. IAS 16

provides more guidance and rules in this area, explaining that the costs of the day-to-day servicing of an item of property, plant and equipment are not recognised as an asset. Instead such costs are recognised in the operating cost statement as incurred. Day-to-day servicing costs would include costs of labour and consumables and may include the cost of small replacement parts. The purpose of this type of expenditure is often known as 'repairs and maintenance'. The reason why such costs are expensed rather than capitalised is that they do not add to the future economic benefits of the item of property, plant and equipment. Rather they maintain the asset's potential to deliver the level of future economic benefits that it was expected to provide when it was originally acquired. These subsequent repair and maintenance costs do not, therefore, qualify for recognition as an asset in their own right.

2.5.5 In summary, subsequent expenditure on property, plant and equipment should be capitalised in three circumstances:

- where they meet the recognition criteria in the standard, specifically it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably;
- where a component of the asset is replaced or restored the costs of a replacement component are recognised as an asset if they meet the recognition criteria described above and the carrying amount of the part or parts that are replaced is derecognised;
- where the subsequent expenditure relates to a major inspection of the asset the inspection cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised.

IAS 16 gives an example of an aircraft that may be required by law to be inspected/overhauled every three years. In such a case it requires a proportion of the cost of the asset equivalent to the expected overhaul cost to be identified and depreciated over the period to the next inspection/overhaul if it represents a significant part of the asset's cost. The actual cost of the overhaul or inspection is then capitalised, provided that it meets the recognition criteria, that is it is probable that future economic benefits will flow to the entity and the cost can be measured reliably. This inspection/overhaul cost is then depreciated over the period to the next inspection/overhaul. The cost and depreciation attributed to the overhaul originally should be removed from the balance sheet once the cost of the new overhaul has been capitalised to avoid double counting. The remainder of the value of the asset is depreciated over the useful life of the asset, on the basis that the appropriate overhauls will be carried out as they are due.

2.6 Capitalisation Threshold - de minimis limits

2.6.1 Previously Government Departments were allowed to set capitalisation thresholds for non-current assets to suit their own circumstances. NHS Scotland adopted a £5,000 capitalisation threshold for individual assets, although assets of lesser value may be capitalised if they form part of a group, with a group value in excess of £20,000, including VAT where this is not recoverable.

2.6.2 When capitalising assets, NHS bodies should, subject to materiality, take into account the following factors:

- ***practicality:*** keeping the maintenance of asset registers within manageable proportions;

- ***flexibility:*** different threshold limits might be appropriate for different types of fixed asset or between programme assets (e.g. infrastructure) and operating assets (e.g. IT equipment, office furniture);

- ***consistency:*** NHS bodies should ensure an appropriate degree of consistency within the organisation for the production of consolidated departmental resource accounts.

2.6.3 Before making changes to thresholds, prior consultation with SGHSCD is required to consider whether there is a significant impact on expenditure control.

2.7 Grouped assets

2.7.1 'Grouped assets' are a collection of assets which individually may be valued at less than £5,000 but which together form a single collective asset with a group value in excess of £20,000, including VAT where this is not recoverable, because the items fulfil all the following criteria:

- the items are functionally interdependent;
- the items are acquired at about the same date and are planned for disposal at about the same date;
- the items are under single managerial control; and
- each individual asset thus grouped has a value of over £250.

Assets acquired in the course of the initial setting up of a new building or on refurbishment may also to be treated as 'grouped' for capitalisation purposes. The examples in 2.7.2 and 2.7.5 highlight where such an approach is more likely to be applied.

2.7.2 Networked systems: Large collective networked system developments where individual items of computer hardware and/or software are purchased as part of a larger system e.g. Patient Administration System, and which will be used as a part of that system for the duration of their asset life.

2.7.3 The rationale behind permitting such a form of 'grouping' is that smaller items of expenditure should be recognised as having a useful life, in relation to the overall strategy over a number of years, and as a result should be capitalised rather than written off in the current year. Such expenditure must not only meet the criteria for grouping assets but also the IAS 16 definition of property, plant and equipment, highlighted in paragraph 2.3.1 above.

2.7.4 In order to justify the adoption of this approach, the items should all be purchased within a reasonable time frame (no more than 1 financial year), and the total combined cost of the individual assets should be no less than £20,000. For incremental upgrades, roll-outs or replacements where the individual components cost less than £5,000, the expenditure should not simply be added to the original system value, but should be separately assessed in its own right as a system development, in deciding whether to capitalise or write-off to revenue.

2.7.5 Initial equipping costs: Where applying the de minimis rule to the purchase of a large number of low value items of equipment expenditure would result in an exceptional charge to the Operating Cost Statement in the first year of a new hospital or strategy development Boards have the option to capitalise such expenditure as a single 'equipping' asset with a useful economic life of up to 10 years. The decision on whether or not to capitalise such costs is a choice of accounting policy and consequently the Board should ensure consistency in adhering to this accounting policy if it decides that it is the most appropriate way of valuing its fixed assets. Where it is intended to exercise this option, Boards should consult with the SGHSCD.

2.8 Property, plant and equipment- Expenditure to be capitalised

2.8.1 The basic principle in IAS 16 is that items of property, plant and equipment that qualify for recognition should be initially measured at cost.

2.8.2 Measurement of cost is normally straightforward as it is generally the price paid. Where an asset is self-constructed, the production cost will be ascertained by aggregating the price paid for material, labour and other inputs used in the construction.

2.8.3 IAS 16 clarifies which costs can and cannot be capitalised on acquiring or constructing an asset. IAS 16 states that cost of an item of property, plant and equipment comprises:

- The purchase price, including import duties and non-refundable purchase taxes less any trade discounts and rebates.
- Directly attributable costs of bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

- The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. The obligation to incur these costs arises either when the item is acquired or as a result of using the item during a particular period other than for the purpose of producing inventories during that period.

2.8.4 The standard then details costs that are, and are not, 'directly attributable'.

2.9 Directly Attributable costs

2.9.1 Examples of directly attributable costs given in IAS 16 are:

- The cost of employee benefits as defined in IAS 19, 'Employee benefits', that arise directly from the construction or acquisition of the item;
- The costs of site preparation;
- Initial delivery and handling costs;
- Installation and assembly costs;
- Professional fees; and
- Costs of testing whether the asset is working properly (commissioning costs), after deducting the net proceeds of sale of any items produced while bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management (such as samples produced during testing).

2.9.2 Start up costs

Start-up costs and similar pre-production costs do not form part of the cost of an asset. Initial operating losses incurred prior to an asset achieving its planned performance are recognised as an expense. The same would apply to operating losses that occur because a economic benefit earning activity has been suspended during the construction of an item of property, plant and equipment. An example might be where a hospital is being refurbished and is, therefore, closed for a period. The losses incurred in that period (rents, wages etc) would be expensed as incurred as they would not form part of the cost of improvements.

2.9.3 Self-constructed assets

The cost of a self-constructed asset is determined using the same principles as for an acquired asset. The cost of abnormal amounts of wasted material, labour or other resources incurred in the production of a self-constructed asset are not included in the cost of the asset. Other specific types of abnormal costs that would also be excluded are costs related to design errors, industrial disputes, idle capacity and production delays.

2.9.4 Employee benefit costs

- IAS 16 is clear that only those directly attributable labour costs (employee benefits) that relate to the time spent by employees on constructing or acquiring the specific asset should be capitalised. Where an entity's own staff are involved in the acquisition, construction or development of a piece of property, plant and equipment, the relevant proportion of the internal costs relating to those staff should, if material and if the other criteria for capitalisation referred to in this section are met, be included in the cost of the asset, subject to the condition in 2.9.6.

Such internal costs will include own employees' (e.g. site workers, in-house architects and surveyors) salaries and expenses arising directly from the construction and acquisition of the specific tangible fixed asset. Administration and other general overhead costs should be excluded from the cost. Employee costs not related to the specific asset (such as site selection activities) are not directly attributable costs.

Therefore, time spent on other potential acquisitions or developments cannot be included. For example, an internal surveyor may carry out surveys on five different properties as part of the process to determine which one of those properties the Board will buy. The cost of these surveys should not be capitalised as part of the cost of the property which is subsequently bought. However, the cost of a survey of a property after the decision to purchase it (for example, to confirm that decision) would be capitalised.

Furthermore, if a site engineer spends 30 per cent of his time on a particular development project, then only 30 per cent of his employee costs should be capitalised as part of the asset's cost. As a general rule in such situations only incremental costs that would have been avoided had the asset not been constructed can really be directly and conclusively attributed to bringing the asset to its working condition. For example, the cost of a temporary office on the site of the development, that would not have been incurred but for the project, should be capitalised because it is both an incremental and a direct cost that is attributable to bringing the asset to the condition necessary for it to operate in the manner intended by management.

2.9.5 Professional fees

External professional fees incurred in finding a suitable asset, which is then acquired or constructed, may be capitalised. However, costs such as external professional fees should only be capitalised as part of the cost of an asset when they relate directly to the acquisition or construction of the asset. Therefore, costs on speculative projects and costs of aborted plans should not be capitalised. Other professional fees incurred in acquiring an asset such as legal fees and stamp duty would be included in the cost of an asset.

2.9.6 Other incremental costs

Although constructing or acquiring a new asset may result in other incremental costs that would have been avoided only if the asset had not been constructed or acquired, these should not be included in the cost of the asset if they do not bring the asset into the location and condition necessary for it to be capable of operating in the manner intended by management.

For example, the cost of training operatives for new machinery or computer equipment should not be capitalised as they are operating costs rather than directly attributable to the item of property, plant and equipment. This is because as operatives may leave at short notice, their training costs would not meet the definition of an asset and, therefore, may not be capitalised, since the access to future economic benefits is not controlled by the entity.

2.9.7 Decommissioning costs

The cost of an item of property, plant and equipment includes the estimated costs of dismantling and removing the asset and restoring the site on which it is located ('decommissioning costs'). However, this is only allowed when there is a corresponding obligation recognised as a provision under IAS 37, 'Provisions, contingent liabilities and contingent assets'.

At first glance, it seems odd to capitalise decommissioning costs that are not going to emerge until later in the asset's life. However, where the entity has an obligation as a direct consequence of acquiring or constructing property, plant and equipment to incur further costs in the future that it cannot avoid, a provision is recognised in accordance with IAS 37. Therefore, the decommissioning costs at the end of the asset's life are just as much a cost of acquiring or constructing the asset as the costs incurred at the start of the asset's life.

2.10 Non-attributable costs

2.10.1 The standard specifically says that the following are not directly attributable costs and so should be charged directly to the Operating Cost Statement rather than capitalised:

The standard lists types of costs that are not 'directly attributable' as follows:

- costs of opening a new facility;
- costs of introducing a new product or service (including costs of advertising and promotional activities);
- costs of conducting business in a new location or with a new class of customer (including costs of staff training);
- administration and other general overhead costs;
- costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

- initial operating losses, such as those incurred while demand for the item's output builds up;
- costs of relocating or reorganising part or all of an entity's operations;
- employee costs not related to the specific asset (such as site selection activities);
- operating losses that occur because a revenue activity has been suspended during the construction of the asset; and
- abnormal costs e.g. costs relating to:
  - design errors;
  - industrial disputes;
  - idle capacity;
  - wasted materials, labour or other resources; and
  - production delays.

2.10.2 Where 'non directly attributable' costs form part of the total expenditure of a 'capital' project, the amounts not directly attributable will require to be charged to operating costs. The overall funding requirement for the project should be discussed with the relevant finance manager at the Health Department.

2.11 Interest (Borrowing costs)

2.11.1 The revised IAS 23 requires borrowing costs incurred in connection with the acquisition or construction of a qualifying asset (principally property, plant and equipment and intangible assets) to be capitalised and included within the cost of the asset. However, the standard does not apply where such assets are held at a valuation rather than at cost. Thus the requirements of the standard are not mandatory for Boards. The standard notes that it does not preclude entities in this situation from capitalising borrowing costs for initial recognition prior to the first revaluation. Since subsequent asset valuations would not reflect capitalised borrowing costs, an impairment would need to be recognised when the asset were first brought into use, and that impairment would be charged to operating costs. Consequently, the SGHSCD has decided that Boards should not capitalise borrowing costs for initial recognition and thus all borrowing costs should be recognised as operating expenses.

2.12 Initial equipping and setting-up costs of new buildings

2.12.1 Assets individually valued at less than £5,000 may be capitalised (at the discretion of the NHS body) with SGHSCD consultation (2.7.5) as collective assets where they are acquired as part of the setting-up of a new building.

2.13 Demolition costs

2.13.1 Costs incurred in demolishing or rearranging existing assets should be capitalised where this is necessary to allow a new asset to be built. Where no new asset is to be created, these costs must be charged as revenue expenditure.

2.14 Staff training costs

2.14.1 The question of capitalisation of staff training costs associated with the introduction of new assets is occasionally raised. As the nature of the investment is in staff rather then assets directly, such expenditure should always be treated as a revenue expense (2.9.6).

2.15 Equipment

2.15.1 Equipment is initially capitalised at its cost (generally the price paid). Second-hand equipment however should be taken onto the balance sheet at its replacement cost (i.e. the cost of replacing the asset with a new item) with a value for cumulative depreciation recorded to set the net book value of the asset equal to the actual amount paid. For example, equipment that could be purchased new for £20,000 is purchased second-hand for £12,000. The balance sheet will show gross replacement cost of £20,000, cumulative depreciation of £8,000 (to give a net book value of £12,000, equal to the cash paid).

2.15.2 When a second-hand item is acquired, an assessment of its remaining economic life must be made to calculate the depreciation chargeable (see Chapter 5, Depreciation, Asset Lives and Residual Value).

2.16 Leases

2.16.1 Finance leases where the NHS is the lessee will be accounted for as if the underlying asset is owned by the NHS. Chapter 8 (leases) deals with leases.

2.17 Donated assets

2.17.1 This is dealt with in chapter 10 and sections 6.12 of the FReM.

2.18 Assets transferred between NHS bodies

2.18.1 Once a Board has established that a property is surplus to its own requirements and before formally declaring it surplus to the requirements of NHSScotland, it must ensure that there is no wider NHSScotland need for the property by consulting all other Boards. If such assets are to be transferred between Boards these transfers should be accounted for as acquisitions and valued in accordance with IAS 16. The accounting entries are detailed in section 7.16.4 of this manual.

2.18.2 Assets acquired from other Government departments, Local Authorities and other non-NHS bodies, should be purchased at fair value, further details can be found in the Property Transaction Handbook.

2.18.3 The accounting treatment of surplus assets which meet the definition of assets held for sale in the entity disposing of the asset is set out in chapter 7 of this manual.

2.19 Government grants

2.19.1 This is dealt with in chapter 10 of this manual and sections 6.2.69 to 6.2.74 of the FReM.

2.20 Deferred payment

2.20.1 The cost of an item of property, plant and equipment is the cash price equivalent at the date when the asset is recognised. Where an item is acquired on terms that payment is deferred beyond normal credit terms, its cost is the cash price equivalent, that is the discounted amount. The difference between this amount and the total payments is treated as interest payable over the period of credit.

2.21 Infrastructure assets

2.21.1 Infrastructure assets are assets that form part of an integrated network servicing a significant geographical area. These assets usually display some or all of the following characteristics:

- they are part of a system or network;
- they are specialised in nature and do not have alternative uses;
- they are immovable; and
- they may be subject to constraints on disposal.

Examples of infrastructure assets include road networks, sewer systems, water and power supply systems and communications networks.'

It is very unlikely that infrastructure assets, as defined by the FReM, will be found in the NHS. NHS bodies should however contact SGHSCD to discuss the accounting treatment to be adopted where it is believed that renewals accounting may be appropriate.

2.22 Heritage assets

2.22.1 Heritage assets are defined in the FReM as being 'assets that are intended to be preserved in trust for future generations because of their cultural, environmental or historical associations. They are held by the reporting entity in pursuit of its overall objectives in relation to the maintenance of the heritage'.

It is unlikely that an NHS body will have any such assets, as individual works of art lying outside main national collections are unlikely to merit this classification.

2.22.2 Non-operational heritage assets are those that are held primarily for the purpose outlined in 2.22.1 above. These assets should be treated according to the principles prescribed in the FReM. It will be necessary for any NHS Board holding what may be considered as non-operational heritage assets to discuss their classification and accounting treatment with SGHSCD.

2.22.3 Operational heritage assets, as defined in chapter 6 of the FReM are 'those that, in addition to being held for their characteristics as part of the nation's heritage, are also used by the entity for other activities or to provide other services (e.g. buildings)'. These assets should be treated as any other type of tangible fixed asset in terms of valuation, depreciation and capital charges.

3. Recognition and Initial Measurement of Intangible Assets

3.1 General principles and definitions

3.1.1 Assets are defined in paragraph 49(a) of the International Accounting Standards Board's Framework for the preparation and presentation of financial statements (the 'Framework') as "...a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity".

3.1.2 Intangible assets are non-monetary assets without physical substance which are capable of being sold separately from the rest of the Board's business or which arise from contractual or other legal rights. They are recognised only where it is probable that future economic benefits will flow to, or service potential be provided to, the Board and where the cost of the asset can be measured reliably.

3.1.3 For non-cash generating data assets, e.g. the content of a database, the term 'future economic benefit' as used in IAS 38 should be interpreted as 'future service potential' - that is, a direct contribution to the delivery of services to the public. For other non-cash generating intangible assets which otherwise meet the requirements of IAS 38, e.g. internally generated software, 'future economic benefit' should be interpreted as contributing to future cost savings.

3.1.4 Access to economic benefits can be obtained in various ways. Usually it is obtained by ownership of goods. Sometimes similar access to economic benefits may be obtained without legal ownership, for example where goods are leased by way of a finance lease. In these circumstances, the asset may be barely distinguishable in terms of financial commitment and opportunity for 'risk and reward' from that obtained through legal title. Therefore the accounts should reflect the commercial substance of the transaction. Substance over form and application of IAS 17 Leases, SIC 15 Operating Leases – Incentives, SIC 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease, IFRIC 4 Determining whether an Arrangement contains a Lease, and IFRIC 12 Service Concession Arrangements are dealt with more fully in Chapter 7 of the FReM.

3.1.5 As a minimum, Boards should analyse their intangible assets under the following headings:

- information technology – software developed in-house or by third parties (but not software licences);
- software licences – the right to use software developed by third parties;
- websites that deliver services;
- development expenditure;
- licences, trademarks and artistic originals – original films, sound recordings, etc. on which performances are recorded or embodied;
- patents – inventions that are afforded patent protection; and
- goodwill.

3.2 Intangible assets - recognition

3.2.1 A Board may obtain an intangible asset in a number of ways:

- By developing or generating the asset internally.
- By separate acquisition for monetary or other consideration.
- By way of government grant.

Further guidance on the recognition of websites is provided in Appendix I.

3.2.2 If the asset meets the definition of an intangible asset as outlined above in 3.1, it must also meet two recognition criteria (in common with all non-current assets) before it can be capitalised. These are:

- Future Economic Benefit – it must be probable that the expected future economic benefits will flow to the entity
- Cost – must be able to measure reliably.

3.2.3 If the asset meets the definition and recognition criteria, then it can be capitalised and should be measured initially at cost. Note however that for internally generated intangible assets, cost can only be recognised at the stage when the asset is capable of generating future economic benefits and all costs incurred before this stage should be treated as an expense.

3.3 Internally generated intangible assets

3.3.1 Expenditure involved in the internal generation of an intangible asset falls into two phases - a research phase and a development phase. 'Research' is defined as "…original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding". 'Development' is defined as "…the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use".

If the two phases are indistinguishable all the expenditure on the asset should be attributed to the research phase.

3.3.2 No intangible assets can be recognised during the research phase and all such costs must be recognised as operating expenses.

3.3.3 Internally generated goodwill, brands, mastheads, publishing titles, customer lists and similar items are not capitalised as intangible assets.

3.3.4 Expenditure on development should only be capitalised where the criteria in 3.4 below have been met.

3.4 Internally generated intangible assets - Development Expenditure

3.4.1 Expenditure on development is capitalised only where all of the following can be demonstrated:

- the project is technically feasible to the point of completion and will result in an intangible asset for sale or use;
- the Board intends to complete the asset and sell or use it;
- the Board has the ability to sell or use the asset;
- how the intangible asset will generate probable future economic benefits can be demonstrated e.g. the presence of a market for it or its output, or where it is to be used for internal use, the usefulness of the asset;
- adequate financial, technical and other resources are available to the Board to complete the development and sell or use the asset; and
- the Board can measure reliably the expenses attributable to the asset during development.

3.5 Purchased intangible assets (separate acquisition)

3.5.1 Intangible assets can be purchased separately, or as part of a business combination. The latter scenario reflects business combinations under IFRS 3 and therefore Boards might only recognise these in situations where a business has been acquired from outside the public sector.

3.6 Donated intangible assets

3.6.1 This is dealt with in chapter 10 and sections 6.2.18 to 6.2.22 of the FReM.

3.7 Goodwill

3.7.1 It is not expected that goodwill will arise for NHS bodies.

3.8 Software

3.8.1 Software which is integral to the operation of hardware e.g. an operating system, is capitalised as part of the relevant item of property, plant and equipment. Software which is not integral to the operation of hardware e.g. application software, is capitalised as an intangible asset.

3.9 Website costs

3.9.1 SIC 32 gives guidance specifically on the type of expenditure to be considered in the planning and development phases of internally generated websites projects. If the web site meets the conditions for capitalisation, the key issue is to correctly identify which phase the costs of the project are attributable to.

3.9.2 Paragraph 8 of SIC 32 specifically states that 'an entity will not be able to demonstrate that a website developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site will be recognised as an expense when incurred.' For the public sector, it has been made clear that web sites designed for the purpose of informing stakeholders of the services or other objectives of the reporting entity should not be capitalised.

3.9.3 FRAB paper (91)06 gives an example of a database populated with information provided by the public on payment of a statutory fee. The entity sells this information on to another party and thereby generates income from the database of information that it holds. The database does not constitute an income generating asset unless the information is sold on as the statutory fee would have been payable regardless of how the information was recorded by the entity.

3.9.4 Further guidance on the application of SIC 32 is given in Appendix I.

3.10 EU Emission Allowance Trading Scheme

3.10.1 Where Boards are members of the EU Greenhouse Gas Emission Allowance Trading Directive the scheme gives rise to an intangible asset in relation to allowances held for use on a continuing basis. If not held for use on a continuing basis, they should be classified as current assets, within current asset investments.

3.10.2 The allowance held for use should be shown valued at fair value even when it is acquired for less than fair value. The intangible fixed asset is written down at the year end to the extent that the Board has made emissions and used up its allowances. If allowances are traded then the NHS Board could generate a loss or profit on disposal.

3.11 Internally generated intangible assets – initial measurement

3.11.1 Intangible assets are measured initially at cost.

3.11.2 Once the recognition criteria have been satisfied, the cost of an internally generated intangible asset is the sum of subsequent directly attributable expenditure incurred to create, produce and prepare the asset so that it is capable of operating in the manner intended by management.

3.11.3 Examples of directly attributable costs given in paragraph 66 of IAS 38 are:

- Costs of materials and services used or consumed in generating the intangible asset.
- The cost of employee benefits, as defined in IAS 19, 'Employee benefits', that arise directly from the generation of the asset. It should be noted that there is no requirement for these costs to be incremental. There is not, therefore, a requirement for an employee to

have been specifically hired to develop the internally generated intangible asset, for the employee benefit costs to be capitalised. It is sufficient that the employee has incurred time working on the relevant project.

- Fees paid to register a legal right, such as patent registration fees.
- Amortisation of patents and licences that are used in generating the asset.

3.11.4 The types of costs described above are being incurred while an intangible asset is being generated. Further capitalisation may also be possible during the commissioning phase before an asset is capable of operating in the manner intended by management. For example, the cost of testing whether an item is functioning properly is specifically identified in paragraph 28 of IAS 38 as being a directly attributable cost of a separately acquired intangible asset. Such a cost would be an equally valid cost in relation to an internally generated intangible asset.

3.11.5 Only the costs that are directly attributable to generating the intangible asset, and not the general costs of the operation, may be capitalised. The standard lists types of costs that are not 'directly attributable' and, therefore, are not components of the cost of an internally generated intangible asset as follows:

- Selling, administration and other general overhead costs, unless they can be directly attributed to preparing the asset for use.
- Inefficiencies and initial operating losses incurred before the asset achieves planned performance.
- Training costs for staff that will operate the asset.

3.11.6 The capitalisation of costs stops when the asset "is capable of operating in the manner intended by management". This means that if an asset is internally generated (constructed) and can operate in that manner immediately, but is not brought into use immediately, costs incurred whilst the asset is standing idle may not be capitalised.

3.11.7 Costs incurred in using or redeploying an item are not included in its carrying amount. The types of costs that may fall into this category are as follows:

- Costs incurred while an item that is capable of operating in the manner intended by management has yet to be brought into use.
- Initial operating losses, such as may be incurred while demand for an item's output builds up.

3.11.8 Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date.

3.12 Purchased intangible assets (separate acquisition) – initial measurement

3.12.1 Intangible assets are initially measured at cost. The cost of a separately acquired intangible asset (including in-process research and development projects) can usually be reliably measured. This is particularly so for assets acquired for cash.

3.12.2 Cost for an intangible asset comprises:

- the purchase price, including import duties and non-refundable purchase taxes. Trade discounts and rebates are deducted in arriving at the purchase price; plus
- any directly attributable cost of preparing the asset for its intended use.

3.12.3 Directly attributable costs include:

- The cost of employee benefits as defined in IAS 19, 'Employee benefits', that arise directly from bringing the asset into its working condition. It should be noted that there is no requirement for these costs to be incremental. There is not, therefore, a requirement for an employee to have been specifically hired to prepare the asset for intended use, for the employee benefit costs to be capitalised. It is sufficient that the employee has incurred time working on the relevant project.
- Professional fees.
- Costs of testing whether the asset is working properly.

3.12.4 In practice the directly attributable costs referred to above are more likely to arise where an intangible asset is internally generated, rather than acquired separately. Therefore, these types of cost are discussed in more detail above. However, an intangible asset that is acquired separately may sometimes still require expenditure to bring it into working condition, so the guidance in section 15.10 may be relevant in these circumstances.

3.12.5 Expenditure that does not form part of the cost of an intangible asset includes:

- The cost of introducing a new product or service, including advertising costs and promotional activities. On the other hand, the development cost of a new product, as opposed to the cost of introducing it, may qualify for recognition.
- Costs of conducting business in a new location or with a new class of customer, including training costs.
- Administration and other general overheads.

3.12.6 Capitalisation of eligible costs should cease when the asset is capable of operating in the manner intended by management. Costs of using the asset or for redeploying it to other uses or another location are not capitalised. Such costs include any that are incurred while an asset is capable of operating in the manner intended by management and any initial operating losses, such as those that might be incurred while demand builds up for the asset's output.

3.13 Subsequent expenditure

3.13.1 The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in IAS 38. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole. Therefore, only rarely will subsequent expenditure—expenditure incurred after the initial recognition of an acquired intangible asset or after completion of an internally generated intangible asset—be recognised in the carrying amount of an asset.

3.14 Capitalisation Threshold - de minimis limits

3.14.1 The guidance on capitalisation thresholds in section 2.6 above for property, plant and equipment is equally relevant to intangible assets.

3.15 Grouped assets

3.15.1 The guidance on grouped assets in 2.7 above for property, plant and equipment is equally relevant to intangible assets.

3.16 Interest (Borrowing costs)

3.16.1 The guidance on capitalisation of borrowing costs in 2.11 above for property, plant and equipment is equally relevant to intangible assets.

3.17 Staff training costs

3.17.1 The guidance on staff training costs in 2.14 above for property, plant and equipment is equally relevant to intangible assets.

3.18 Leases

3.18.1 Finance leases where the NHS is the lessee will be accounted for as if the underlying asset is owned by the NHS. Chapter 8 (leases) deals with leases.

3.19 Donated assets

3.19.1 This is dealt with in chapter 10 of this manual and sections 6.2.19 to 6.2.23 of the FReM.

3.20 Assets transferred between NHS bodies

3.20.1 Once a Board has established that an intangible asset is surplus to its own requirements and before formally declaring it surplus to the requirements of NHSScotland, it must ensure that there is no wider NHSScotland need for the asset by consulting all other Boards. If such assets are to be transferred between NHS bodies the transfer should be accounted for as acquisitions and valued in accordance with IAS 38.

3.20.2 Assets acquired from other Government departments, Local Authorities and other non-NHS bodies, should be purchased at fair value, further details can be found in the Property Transaction Handbook.

3.20.3 The accounting treatment of surplus assets which meet the definition of assets held for sale in the entity disposing of the asset is set out in chapter 6 of this manual.

3.21 Government grants

3.21.1 The guidance on government grants in chapter 10 for property, plant and equipment is equally relevant to intangible assets.

Appendix I – Example application of SIC-32

The purpose of the appendix is to illustrate examples of expenditure that occur during each of the stages described in paragraphs 2 and 3 of the Interpretation(SIC 32) and illustrate application of the Interpretation to assist in clarifying its meaning. It is not intended to be a comprehensive checklist of expenditure that might be incurred.

Stage / Nature of Expenditure	**Accounting treatment**
Planning • undertaking feasibility studies • defining hardware and software specifications • evaluating alternative products and suppliers • selecting preferences	Recognise as an expense when incurred in accordance with IAS 38.54
Application and Infrastructure Development • purchasing or developing hardware	Apply the requirements of IAS 16
• obtaining a domain name • developing operating software (e.g. operating system and server software) • developing code for the application • installing developed applications on the web server • stress testing	Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57
Graphical Design Development • designing the appearance (e.g. layout and colour) of web pages	Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57

Content Development • creating, purchasing, preparing (e.g. creating links and identifying tags), and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. Examples of content include information about an entity, products or services offered for sale, and topics that subscribers access	Recognise as an expense when incurred in accordance with IAS 38.69(c) to the extent that content is developed to advertise and promote an entity's own products and services (e.g. digital photographs of products). Otherwise, recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57
Operating • updating graphics and revising content • adding new functions, features and content • registering the web site with search engines • backing up data • reviewing security access • analysing usage of the web site	Assess whether it meets the definition of an intangible asset and the recognition criteria set out in IAS 38.18, in which case the expenditure is recognised in the carrying amount of the web site asset
Other • selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use to operate in the manner intended by management • clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance (e.g. false-start testing) • training employees to operate the web site	Recognise as an expense when incurred in accordance with IAS 38.65-.70

4. Subsequent Measurement of Property, Plant and Equipment and Intangible assets

4.1 Introduction

4.1.1 Subsequent to initial recognition an item of property, plant and equipment or an intangible asset should be carried at:

- cost or revalued amount;
- less any subsequent accumulated depreciation / amortisation;
- less any subsequent impairment losses.

4.1.2 The basis of valuation is considered in section 4.2 below.

4.1.3 Chapter 5 deals specifically with depreciation and amortisation.

4.1.4 Chapter 6 deals specifically with impairment.

4.2 Basis of valuation

Valuation model

4.2.1 For subsequent measurement of property, plant and equipment and intangible assets, Boards must follow the Revaluation Model in IAS 16 and IAS 38 respectively. The Cost Model approach for subsequent measurement in the Standards is not permitted.

4.2.2 Valuation of property, plant and equipment and intangible assets is on the basis of historical cost modified to reflect the value of assets by reference to their fair value. IAS 16 and IAS 38 define fair value as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date'.

4.2.3 For property, plant and equipment IAS 16 states that fair value is usually 'determined from market-based evidence' (for land and buildings) or 'market value' (for plant and equipment), which is generally taken to mean open market value.

4.2.4 In accordance with paragraph 7.2.5 of the FReM where an active (homogeneous) market exists, intangible assets should be carried at fair value at the reporting period date. Where no active market exists, the Board should revalue the asset, using indices or some suitable model, to the lower of depreciated replacement cost and value in use where the asset is income generating. Where there is no value in use, the asset should be valued using depreciated replacement cost. These measures are a proxy for fair value.

4.2.3 The NHS in Scotland adopts a policy of revaluation within the meaning of IAS 16 and IAS 38, and must consistently apply revaluation policies to each asset within a given class of assets. An item of property, plant and equipment or an intangible asset's carrying amount at the balance sheet date should be the revalued amount, determined according to these policies.

4.2.4 Where an item of property, plant and equipment is revalued, any accumulated depreciation at the date of revaluation is treated in one of the following ways:

(a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to determine its depreciated replacement cost.

(b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. This method is often used for buildings.

4.3 Frequency of valuations

4.3.1 For land and buildings, the revaluation from cost should take place as soon after the date of acquisition or occupation of new buildings as possible, and in any event before the end of the financial year in which the asset is acquired or created. Other assets should only be revalued on the next occasion when all assets of that class are re-valued.

4.3.2 The value at which assets are included in the balance sheet should be reviewed annually and where an asset's value has changed materially the valuation should be adjusted accordingly. This review will be through a mixture of professional valuation and application of appropriate price indices, dependent on the nature and types of asset. NHS bodies should use such indices as they consider most appropriate, given their own individual circumstances. Having identified appropriate indices, NHS bodies should be consistent with their application from one period to another. They should include in their accounting policies a brief description of the indices that they have used.

4.3.3 Each Board needs to ensure that the whole of the estate is revalued every 5 years. NHS bodies may choose to do this as a single exercise every five years or by way of a rolling programme. Any property not fully revalued in year will require an interim revaluation on 31st March, either by applying appropriate indices from a professional valuer or by interim revaluation. SGHSCD no longer intends to issue indices for land or buildings so NHS Boards should make appropriate arrangements with their valuers to adjust values of properties in years between full revaluations.

4.3.4 It should be noted that revaluations can be carried out at any date in year and then indexed from the date of the valuation to the 31st March to produce the year end valuation; they must be stated as at 31 March.

4.3.5 Professional revaluations of individual assets will otherwise be required when:

- there is an indication that assets may have suffered impairment (see chapter 6 below); or,
- property has been subject to enhancement expenditure; or,
- there has been a change of use or level of utilisation of an asset; or,
- an asset is to be taken out of use, or is surplus to the NHS body's needs (see chapter 7 below).

4.4 Assets under construction

4.4.1 ***Assets under construction*** are revalued in the same way as completed property, plant and equipment and intangible assets. The carrying amount of an asset under construction must be reduced if it becomes apparent that ***fruitless payments*** (which are reported in the losses register) have been incurred or other costs have been inappropriately capitalised.

4.5 Ad-hoc revaluations

4.5.1 IAS 16 requires that where a single item of property, plant and equipment is revalued the entire class of property, plant and equipment to which that asset belongs shall be revalued. This principle has been applied in the guidance given, although individual assets that are professionally revalued in the event of them being impaired or their valuation bases being changed will not require all assets in the same class to be professionally revalued.

4.6 Valuers and Disclosures

4.6.1 Professional Valuers will be commissioned locally by the NHS Board to carry out valuations and to supply indices, as required. The disclosure of accounting policies should cover the 5-yearly revaluations. In the event of revaluations of a class of assets outside the course of the 5-yearly cycle the full disclosure provisions of IAS 16 must be followed.

4.*7* Non-specialised land and buildings

4.7.1 Where it is possible to value a property in the context of an active market in that type of property in the locality, the Appointed Valuer will attach an open-market value (OMV) to the property. In effect, this should be the default valuation policy as it gives a clear, understandable valuation figure. The existence of a vast specialised estate in the NHS, for which there is no active market, confines the use of OMV to such properties as residential accommodation, office buildings and car parks.

4.7.2 Under UK GAAP, properties were valued at open market value for existing use (EUV). The EUV is likely to be the same as the OMV for the property unless it would be sold for a different purpose or there are restrictions for it to be sold on the open market. Paragraph 32 of IAS 16 can validly be

interpreted as either being the market value of the asset in its existing use or its exit value.

4.7.3 Open market value (OMV) and DRC for specialised buildings (see 4.8 below) will be appropriate for most properties but there will be some where OMV will not be appropriate (for example where there are legal restrictions in selling a property or Scottish Ministers do not hold the legal title). These properties should be considered on a case by case basis taking into account the relevant accounting criteria.

4.7.4 All assets should be revalued at 31 March each year (whether operational or non-operational). Land and buildings should be valued using the values or indices provided by the Appointed Valuer to the Board.

4.7.5 In the financial statements Boards should provide information about the approach to valuing their estates.

4.8 Specialised land and buildings

4.8.1 Where, due to the specialised nature of an asset, the fair value is to be determined using a Depreciated Replacement Cost, Boards should have regard to the interpretations in paragraph 6.2.7 of the FReM including the Guidance on Asset Valuation referred to therein and available on the FReM's dedicated website.

4.8.2 Depreciated replacement cost is defined as 'the current cost of replacing an asset with its modern equivalent less deductions for physical deterioration and all relevant forms of obsolescence and optimisation'. The depreciated replacement cost basis uses a modern equivalent asset basis except in the rare cases where the building or site must remain.

4.8.3 Certain assumptions inherent in the Depreciated Replacement Cost (DRC) valuation methodology may lead to DRC valuations being lower than the initial cost of new buildings. Inefficiencies and abnormal costs (above) cannot be capitalised, even as part of initial costs. Certain other costs associated with capital projects are legitimately capitalised initially, yet may not be reflected in DRC valuations. Examples of these might be the cost implications of contractors having to work in an occupied site, or the necessity to put in access roads; the cost of having multiple contracts and phases to construct one building; and the additional cost of inclement weather.

4.8.4 It is therefore possible that the initial revaluation from cost to DRC will lead to an impairment loss which must be recognised in the Operating Cost Statement. The actual cost of construction must initially be shown as an addition to fixed assets and will therefore all be charged against the Capital Resource Limit (CRL).

4.8.5 The DRC valuation methodology employed by the Appointed Valuers analyses property by separate 'components', based on the Building Cost

Information Service (BCIS) definitions. Certain components (e.g. substructure, roof, stairs, windows and external doors) relate to the buildings themselves, while others (water, electrical, heating, lift installations) relate to plant or engineering.

4.8.6 While NHS bodies are required to track various elements in their asset registers separately for component depreciation purposes, it is suggested that for the purposes of impairment reviews and tracking revaluation reserve balances associated with discrete assets, the asset unit should be the building as a whole where all components have been measured using the DRC valuation methodology. Clearly, separate wings or blocks of a building might have been added at different times, and are capable of being treated as separate assets, or indeed significant component of property, plant and equipment may have depreciation lives so different from the structure as to merit treatments as separate assets under IAS 16. Some judgement in defining 'an asset' will therefore need to be exercised. It is suggested that any block or asset capable of separate valuation, or disposal or demolition, be treated as a discrete asset (so the elements of a block would not be assets in IAS 36 terms, whereas the block itself would be).

4.8.7 An exception to this general rule is land included in property. Because land and buildings asset movements are reported separately in Notes to the Balance Sheet, revaluations need to be apportioned between land and buildings, rather than being assigned to the property asset as a whole.

4.8.8 In the financial statements Boards should provide information about the approach to valuing their estates, including a statement (where applicable) that alternative sites have been used in DRC valuations.

4.9 Non-property assets – Plant and Equipment

4.9.1 In accordance with paragraph 6.2.7 (h) of the FReM, Boards may adopt a depreciated historical cost basis as a proxy for fair value in respect of assets which have short useful lives or low values (or both). For depreciated historical cost to be considered as a proxy for fair value, the useful life must be a realistic reflection of the life of the asset and the depreciation method used must provide a realistic reflection of the consumption of that asset. Where such a basis is not used, assets should be carried at fair value and Boards should value them using the most appropriate valuation methodology available. Where non-property assets are carried at depreciated replacement cost it is sufficient to apply indexation and depreciation to the current value of equipment.

4.9.2 The Scottish Government has advised that depreciated historical cost should be applied to the following categories of assets to achieve consistency within the consolidated accounts:

- ICT
- Furniture and Fittings
- Motor Vehicles

- Equipment (e.g. microscopes, photocopiers, trailers, etc)

4.9.3 In the financial statements Boards should provide information including where depreciated replacement cost is used as a proxy for fair value for named classes of assets (where appropriate) and the reasons why; information about any significant estimation techniques (where applicable).

4.10 Intangible assets

4.10.1 Where an active (homogeneous) market exists, intangible assets should be carried at fair value at the reporting period date – that is, the cost option given in IAS 38 has been withdrawn. Where no active market exists, entities should revalue the asset, using indices or some suitable model, to the lower of depreciated replacement cost and value in use where the asset is income generating. Where there is no value in use, the asset should be valued using depreciated replacement cost. These measures are a proxy for fair value.

4.10.2 Even though an asset may have been acquired separately, there is unlikely to be an active market with the characteristics described in IAS 38 (one of which is that prices are available to the public) as purchase costs will usually be negotiated between the buyer and the seller and this information is unlikely to be in the public domain.

4.11 Indexation

4.11.1 Indexation is intended to value assets by reference to fair value without the expense of frequent revaluations. Indexation is simply another means of revaluation but may be identified separately in asset registers.

4.11.2 Indices for land and buildings should be provided by a professional valuer and would normally be based on data available from the Building Cost Information Service (BCIS) and the Valuation Office Property Market Report. Indices are only appropriate for use on those properties or components of properties measured using the DRC valuation methodology.

4.11.3 Indices are intended to reflect price movements anticipated over the course of the following financial year. They are intended to provide indicative values for the year-end balance sheet. Indices for assets other than land and buildings may be used to determine the value of such classes of asset at the balance sheet date, where these are considered to be applicable to the specific assets in those classes held by NHS bodies. Where indices are used, these should be widely recognised and in common use. The source of the index should be disclosed. SGHSCD no longer issues official indexation figures.

4.12 Valuation requirement

4.12.1 All property, plant and equipment and intangible assets, operational and non-operational (including assets held under finance leases and assets

under construction), should be valued at 31 March each year. The basis of valuation will depend on the circumstances appropriate to the specific asset.

4.13 Revaluation Reserve

4.13.1 The revaluation reserve reflects the unrealised element of the cumulative balance of indexation and revaluation adjustments to assets.

4.13.2 A surplus arising on the revaluation of an asset will be credited to the reserve, unless it reverses a previous revaluation loss which was debited to the operating cost statement in a previous financial period, when (after adjusting for subsequent depreciation) it should be credited to the operating cost statement.

4.13.3 Any downward revaluation (including impairment) should be charged against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation reserve in respect of that same asset. Any balance of the decrease should then be recognised as an expense in the operating cost statement.

4.13.4 Each year, the realised element of the reserve (i.e. an amount equal to the excess of the actual depreciation over depreciation based on historical cost) should be transferred from the reserve to the general fund.

4.13.5 The summary of changes in taxpayers' equity in the accounts should disclose the opening and closing balances on the reserve, any amounts transferred to or from reserves during the year, and the source and application, respectively, of the amounts transferred.

4.14 Donated assets

4.14.1 Similar approaches to those above should be adopted for donated assets using the Revaluation Reserve (see also chapter 10).

4.14.2 Donated assets are capitalised at fair value on receipt and are revalued and depreciated in the same way as purchased assets. The value of donated assets is reflected in general reserve, which is credited with the value of the original donation.

4.14.3 On disposal of a donated asset, the profit or loss is taken to the operating cost statement.

4.14.4 Where impairment of a donated asset occurs, the loss in value is charged to the operating cost statement.

4.15 Accounting entries and examples - Revaluation and indexation

4.15.1 Following ***professional valuation***, the purchase cost of an asset may be changed to reflect the new value and the accumulated depreciation to date

written down to zero with a corresponding entry to the revaluation reserve. The effect is such that the revised purchase cost is then depreciated over the remaining life. Only those properties that are fully revalued in the year may be accounted for in this way.

4.15.2 The following alternative entries may be applied in respect of professional revaluation but must be applied following ***indexation or interim revaluation***. The purchase cost ***and*** accumulated depreciation of an asset are proportionally altered, either by the new index or in relation to revalued cost and accumulated depreciation, with a corresponding entry to the revaluation reserve. The revised purchase cost continues to be depreciated over the original economic life, taking account of depreciation accumulated to date.

5. Subsequent measurement - Depreciation, amortisation, residual value and asset lives

5.1 Introduction

5.1.1 In accordance with IAS 16, depreciation should be provided for all property, plant and equipment with a finite useful life by allocating the cost (or revalued amount) less estimated residual value of the assets on a systematic basis over their useful life. The method of depreciation that is used should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the Board. Property, plant and equipment with an indefinite useful life should not be depreciated.

5.1.2 In accordance with IAS 38, amortisation should be provided for all intangible assets with a finite useful life by allocating the cost (or revalued amount) less estimated residual value of the assets on a systematic basis over their useful life. The method of depreciation that is used should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the Board. An intangible asset with an indefinite useful life should not be amortised.

5.2 Depreciation and amortisation policy

5.2.1 The FReM does not specify depreciation and amortisation policies but requires entities within each departmental group to have consistent policies. The policies set in accordance with the Accounts Direction to comply with the FReM are outlined below.

5.2.2 The NHS adopts a policy of straight-line depreciation and amortisation. In accordance with IAS 38 and IAS 16 this method has been judged that which most closely reflects the expected pattern of consumption of economic benefits. This being the policy adopted for the Consolidated Accounts, other methods (e.g. reducing balance, sum of digits methods) are not permissible.

5.2.3 Depreciation and amortisation charged in a period is recognised in the operating cost statement unless it is permitted to be included in the carrying amount of another asset. This will only occur when depreciation or amortisation is included in inventory or work-in-progress as part of an allocation of overheads, in accordance with IAS 2, 'Inventories', or IAS 11, 'Construction contracts', or when it forms part of the cost of another item of property, plant and equipment or intangible asset.

5.3 Useful life

5.3.1 As noted above, depreciation and amortisation is calculated by allocating the cost or revalued amount of an asset less its estimated residual value (that is, its 'depreciable amount') on a systematic basis over its useful life.

5.3.2 Useful life is defined in IAS 16 and IAS 38 as either: "(a) ... the period over which an asset is expected to be available for use by an entity; or (b) the number of production or similar units expected to be obtained from the asset by an entity." Generally, the former of these two will apply, as in most cases it is more straightforward to assess useful lives by reference to time periods.

5.3.3 The definition includes the phrase 'expected to be available for use'. Thus, it is clear that the useful life includes any period after acquisition when the asset is capable of operating in the manner intended by management, but has not yet been brought into use. It is also clear from the definition that the end of the asset's useful life is not necessarily the end of its physical life. This is because the useful life is the period when the asset is used by the entity. If the entity buys an asset that has a physical life of ten years, but the entity intends to use the asset for only six years, the useful life that the entity assigns to the asset will be six years and not ten years.

5.3.4 IAS 16 and IAS 38 requires that the useful lives of property, plant and equipment and intangible assets should be reviewed at least at each year end and, if expectations are different from previous estimates, the change should be accounted for as a change in estimate in accordance with IAS 8, 'Accounting policies, changes in accounting estimates and errors'. IAS 8 requires that the effect of a change in estimated useful life should be accounted for by adjusting the depreciation charge for the current period insofar as the change affects the current period and by adjusting the charge for future periods to the extent that it affects the future periods.

5.3.5 An example that illustrates this treatment is as follows:
Entity A purchased an asset on 1 January 20X0 for 100,000 and the asset had an estimated useful life of 10 years and a residual value of nil. The entity has charged depreciation using the straight-line method at 10,000 per annum. On 1 January 20X4, when the asset's net book value is 60,000, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years and, therefore, the total life is revised to 8 years. The entity should amend the annual provision for depreciation to charge the unamortised cost (namely, 60,000) over the revised remaining life of four years. Consequently, it should charge depreciation for the next 4 years at 15,000 per annum.

5.4 Residual value

5.4.1 As noted above, depreciation and amortisation is calculated by allocating the cost or revalued amount of an asset less its estimated residual value (that is, its 'depreciable amount') on a systematic basis over its useful life.

5.4.2 IAS 16 and IAS 38 defined the residual value of an asset as 'the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life'.

5.4.3 In accordance with IAS 38 the residual value of an intangible asset with a finite useful life should be assumed to be zero, unless:

- a third party has committed to purchase the asset at the end of its useful life; or
- there is an active market for the intangible asset; and residual value can be determined by reference to that market; and the market is likely to exist at the end of the asset's useful life.

5.4.4 Residual values should be based on prices current at the balance sheet date, that is the residual value takes account of price changes up to that date (but not future price changes).

5.4.5 IAS 16 and IAS 38 require that the residual values of property, plant and equipment and intangible assets should be reviewed at least at each year end and, if expectations are different from previous estimates, the change should be accounted for as a change in estimate in accordance with IAS 8, 'Accounting policies, changes in accounting estimates and errors'. IAS 8 requires that the effect of a change in residual estimated useful life should be accounted for by adjusting the depreciation charge for the current period insofar as the change affects the current period and by adjusting the charge for future periods to the extent that it affects the future periods.

5.5 Componentisation

5.5.1 IAS 16 requires that each part of an item of property, plant and equipment that has a cost that is significant when compared to the total cost of the item, should be depreciated separately. The amount initially recognised for an item of property, plant and equipment should be allocated to its significant parts, which must then be depreciated separately. (This may be contrasted with land and buildings, which the standard states are separate assets for depreciation purposes rather than separate parts of the same asset). There is, therefore, a need for Boards to review whether or not an asset has significant parts. If it decides it has, then the significant parts should be depreciated individually, unless the exception described in the next paragraph applies.

5.5.2 Where significant parts of an item of property, plant and equipment have been separately identified in accordance with the standard they should normally be depreciated separately. However, where one significant part has a useful life and a depreciation method that is the same as those of another part of that same item of property, plant and equipment, the two parts may be grouped together for depreciation purposes.

5.5.3 Land and buildings should always be separated and any componentisation threshold agreed with auditors.

5.6 Land and Building Assets

5.6.1 Land is not depreciated, because it is considered to have an infinite life.

5.6.2 Building assets are depreciated over the period of their estimated useful lives, as determined by Appointed Valuers' valuations. Property consists of land and building elements, and valuers will apportion the cost of the property between (depreciable) buildings and (non-depreciable) land elements.

5.6.3 Surplus land and buildings which meet the definition of non-current assets held for sale in accordance with IFRS 5 and should be reclassified as such and should not be depreciated. For further guidance on non-current assets held for sale refer to chapter 7.

5.6.4 Properties that are surplus to requirements but which do not meet the definition of non-current assets held for sale in accordance with IFRS 5 should continue to be revalued and depreciated in accordance with the policies above. In practice this will include properties identified as surplus which will not be available for sale until no longer in operational use. Guidance on valuation of such properties is also given in chapter 7.

5.*7* Plant and Equipment

5.7.1 Plant and equipment assets are depreciated over the period of their estimated useful lives. Suggested lives are provided below:

- Short life engineering plant and equipment - 5 years
- Medium life engineering plant and equipment – 10 years
- Long life engineering plant and equipment – 15 years
- Vehicles – 7 years
- Furniture – 10 years
- Office and IM&T equipment – 5 years
- Soft furnishings – 7 years
- Short life medical and other equipment – 5 years
- Medium life medical equipment – 10 years
- Long life medical equipment – 15 years
- Long life IM&T installations – 8 years

5.7.2 It is recognised that within the NHS there may also be non-standard assets i.e. those which do not readily fit into the categories listed in 5,7.1 above. In this case, an individual assessment of the asset life will be required and asset depreciated accordingly.

5.8 Assets under construction

5.8.1 Assets under construction are not depreciated, because depreciation is appropriate only when assets are available for operational use.

5.9 Intangible assets

5.9.1 Under IFRS, intangible assets can have an indefinite useful life. Whilst this is possible it is more likely that intangible assets will have a short (and therefore finite) useful life.

5.9.2 An intangible asset with a finite useful life is amortised over its expected useful life. An intangible asset with an indefinite useful life is not depreciated.

5.9.3 The EU Greenhouse Gas Emission Allowance Trading scheme gives rise to an intangible asset in relation to allowances held for use on a continuing basis for those Boards to whom it applies. The allowance held for use should be shown valued at fair value even when it is purchased for less than fair value. The intangible fixed asset is written down at the year end to the extent that the NHS Board has made emissions and used up its allowances.

5.10 Finance leases

5.10.1 An asset leased under a finance lease should be depreciated over the shorter of the lease term and its useful life, unless there is a reasonable certainty the lessee will obtain ownership of the asset by the end of the lease term in which case it should be depreciated over its useful life. IAS 17 defines the useful life of an asset as the estimated remaining period, from commencement of the lease term, without limitation by the lease term, over which the economic benefits embodied in the asset are expected to be consumed by the entity. The depreciation policy used should be consistent with that for other depreciable assets that are owned by the entity.

5.11 Depreciation and Amortisation Chargeable period

5.11.1 NHS bodies have the option to calculate depreciation and amortisation monthly or quarterly, with additions and disposals requiring to be accounted for accordingly. Hence, in the following paragraphs NHS bodies should interpret 'period' to be 'month' or 'quarter', as appropriate.

5.12 Commencement of depreciation and amortisation

5.12.1 Depreciation and amortisation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

5.12.2 The date at which an asset becomes available for use will not always be clear and a realistic approach must be adopted in deciding the appropriate date. The minimum period after which it would be expected that depreciation is applied is one quarter after the asset becomes available for use.

5.12.3 Buildings are deemed to become available for use at the earlier of:

- first use;
- the date Unified Business Rate first becomes payable (whether at full or half rate).

5.13 Cessation of depreciation and amortisation

5.13.1 Depreciation and amortisation ceases when an asset is derecognised. Derecognition is deemed to arise when the asset is no longer available for use and is removed from the asset register. This will occur because the asset is:

- sold (or ownership is transferred, e.g. in PFI transactions);
- recorded in the asset register and losses register as being lost or destroyed. An asset that is totally lost or destroyed will be accounted for as being disposed. If a partial loss occurs, e.g. when an asset is damaged, this is treated as an impairment and the net book value of the asset will be reduced as appropriate. This will result in a reduced depreciation charge.
- scrapped.

5.13.2 Therefore, depreciation and amortisation does not stop when an asset is idle.

5.13.3 Depreciation and amortisation will cease to be charged where the asset is classified as held-for-sale under IFRS 5. This would be where the asset is available for immediate sale in its present condition and the other conditions in IFRS 5 have been complied with (see further chapter 7).

5.14 Transfer of an asset under construction to use

5.14.1 Assets under construction are not subject to depreciation, but when they become available for use they must be reclassified as property, plant or equipment or intangible assets and subsequently depreciated or amortised.

5.15 Disposal of assets

5.15.1 Depreciation and amortisation is chargeable in the period until an asset meets the definition of a non-current asset held-for-sale in accordance with IFRS 5. Depreciation and amortisation will cease to be charged where the asset is classified as held-for-sale under IFRS 5 (see further chapter 7).

5.16 Collective assets

5.16.1 Collective or grouped assets should be treated as single assets for the calculation of depreciation.

5.17 Fully depreciated assets

5.17.1 An asset may reach the end of its useful economic life and be fully depreciated, giving a nil net book value (assuming a nil residual value). If it continues to be used, no adjustment is made in the books and its cost and accumulated depreciation continue to be reflected until it is no longer available for use. Fully depreciated assets should continue to be recorded in the asset register. The replacement cost and accumulated depreciation continue to be revalued even where the net book value remains nil.

5.17.2 The necessity to adopt this treatment should be rare under IFRS, as estimates of useful economic life are required to be reviewed annually.

5.18 Non-depreciation of certain assets

5.18.1 An argument is sometimes put forward that assets with very long lives and/or high residual values and/or which are maintained to a high standard will attract immaterial levels of depreciation. In the NHS all assets, including those falling into this category, should be depreciated as a matter of policy to achieve consistency.

5.19 Depreciation calculation – On revalued assets

5.19.1 IAS 16 specifies that all the depreciation chargeable on revalued assets must be recognised as an expense in the Operating Cost Statement. However, as assets are required to be revalued at the balance sheet date and depreciation is calculated on opening values the effect of the year end revaluation on depreciation will not be accounted for until the following years.

5.19.2 NHS bodies should release an amount from the ***revaluation reserve*** to the ***General fund*** in respect of the excess of revalued depreciation over historic cost. This transfer avoids the anomaly of the revaluation reserve remaining in perpetuity after an asset has become fully depreciated. It is also justified as it recognises a realised profit in Companies Act terms.

5.19.3 For this purpose, 'historic cost' means the value at which an asset was taken on to the fixed asset register if no historical cost information is

otherwise available. Subsequent expenditure on an asset will have the effect of increasing its 'historic cost'. The historic cost depreciation figure will then comprise an element for depreciation on the enhancement (as if it were a separate, new asset) to the original figure.

5.19.4 The following example illustrates the transfers required from the revaluation reserve to the General fund in respect of a revalued asset.

Example 1: Treatment of Depreciation in the Balance Sheet

Asset purchased on 1 April for 100, written off over 5 years, increase in valuation of 10% pa.

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Gross Cost					
Opening	100	110	121	133	146
Revaluation	10	11	12	13	14
Closing	110	121	133	146	160
Accum. Depreciation					
Opening		22	48	79	116
Depreciation	20	22	24	27	30
Revaluation	2	4	7	10	14
Closing	22	48	79	116	160
NBV	88	73	54	30	0

Depreciation charged to the Operating Cost Statement

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Depreciation	(20)	(22)	(24)	(27)	(30)

Depreciation charged on revalued amounts can be calculated:

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Depreciation	20	22	24	27	30
Depreciation on historic cost basis	20	20	20	20	20
Excess over historic cost depreciation	0	2	4	7	10

Applying the adjustment to the revaluation reserve:

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Opening	0	8	13	14	10
Revaluation	8	7	5	3	0
Depreciation (Transfer to the General fund)		(2)	(4)	(7)	(10)
C/B	8	13	14	10	0

In year 2 the book keeping entries would be:

Dr	Property, plant and equipment – Gross cost – revaluation	11	
Cr	Property, plant and equipment – Accumulated depreciation – revaluation		4
Cr	Revaluation reserve		7
	To record revaluation		

Dr	Operating Cost Statement- depreciation charge for the year	22	

Cr	Property, plant and equipment – Accumulated depreciation – YTD depreciation		22
	Depreciation charge for the year		

Dr	Revaluation reserve	2	
Cr	General fund		2
	Realised element in respect of depreciation charge in excess of that on HC		

On the disposal of revalued assets, profit or loss is the difference between the sale proceeds and the carrying amount (i.e. at the revaluation value). Any remaining balance on the revaluation reserve should be transferred to the General Fund.

6. Subsequent measurement – Impairment

6.1 Basic principles of impairment

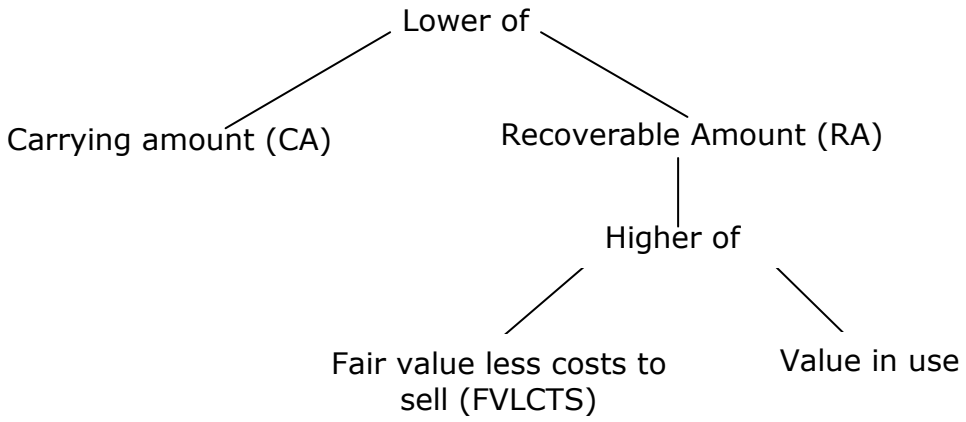
6.1.1 In accordance with IAS 36, an item of property, plant and equipment or an intangible asset may not be carried in the balance sheet at more than its recoverable amount.

6.1.2 An impairment review involves estimating an asset's recoverable amount and comparing it with its carrying value. If the recoverable amount is lower than the carrying value, the asset is impaired and must be written down to the recoverable amount. An impairment cannot be avoided by arguing that the reduction in value is not permanent.

6.1.3 An asset's recoverable amount represents its greatest value to the business in terms of the cash flows that it can generate. That is the higher of:

- fair value less costs to sell (see 6.2 below); and
- value in use (see 6.3 below).

6.1.4 The impairment process can be expressed diagrammatically as described below:



6.2 Fair value less costs to sell

6.2.1 Fair value less costs to sell is defined as the amount for which the asset could be sold in an arm's length transaction between knowledgeable and willing parties, net of estimated costs of disposal.

6.2.2 Where the revalued asset's fair value is based on market value the only difference between that value and the fair value less costs to sell will be the direct incremental costs of disposing of the asset. Where these are negligible the recoverable amount (higher of fair value less costs to sell and value in use) will be close to, or greater than, the carrying amount and no impairment test is required. Where, however, the incremental disposal costs are material or where the fair value (carrying value) of a revalued

asset is determined on a basis other than its market value the carrying amount may be greater or less than its recoverable amount and the standard should be applied as normal to determine whether or not there is an impairment loss.

6.3 Value in use

6.3.1 Value in use is defined as the present value of the future cash flows that are expected to be derived from the asset. The expected future cash flows include those from the asset's continued use in the business and those from its ultimate disposal. Value in use would normally be based on present value calculations.

6.3.2 The not-for-profit nature of the vast majority of NHS bodies' activities however means that value in use is not always measurable in terms of income. In these cases, paragraph 8.2.5 of the FReM clarifies that value in use is assumed to equal the cost of replacing the service potential provided by the asset, unless there has been a reduction in service potential. Such a reduction can arise for various reasons, including:

a) the purpose for which the asset was acquired is no longer carried out and there is no alternative use for the asset;

b) the asset is to be sold;

c) the asset cannot be used;

d) the asset is otherwise surplus and has no alternative use;

e) the asset is over specified for its current use (e.g. building constructed for a specialised purpose currently used as a store).

6.3.3 In the case of (a–d) above, the recoverable amount will be the asset's fair value less costs to sell – i.e. the amount at which the asset could be disposed of, less any disposal costs where the asset is no longer being used for the specialised purpose. In the case of the example in e), it will be the value of a store – i.e. without the higher specification.

6.3.4 Where an asset continues to provide its existing service potential in advance of future planned sale or other event that will reduce its current service potential, this impairment should be recognised to the extent of the current service potential that is expected to be foregone. For assets valued at Depreciated Replacement Cost on the basis of current specialised use this can be assessed by comparing their recoverable amount with their anticipated carrying value at the point their specialised use is expected to cease and recognising any reduction as an impairment. In normal practice this will relate to the excess of anticipated Depreciated Replacement Cost over Fair Value at the point in time the properties are available for disposal or non-specialised use. For surplus hospital buildings that are expected to be closed several years after they are declared surplus this will involve further depreciating the current DRC valuation in respect of the period until their current use is expected to cease and comparing that to their fair

(market) values with any difference being charged as an impairment in Annually Managed Expenditure. The normal level of depreciation can then be applied to the reduced value of the properties so that their carrying values are depreciated down to their market values over the period of their remaining specialised use. In practice a reassessment of the remaining specialised use and market values will be required each year after the property has been declared surplus to adjust for any further changes in these factors and account for any resulting additional impairment or reversal of initial impairment required.

6.3.5 Where, however, there is a reduction in the service potential of an asset which then remains in partial use providing a lower level of service, the asset will be written down immediately to its recoverable amount. This will reflect the capacity to provide that lower level of service. The written down value of the asset will be depreciated taking into account any change in the asset's life or residual value.

6.4 Requirements for an impairment review

6.4.1 Property, plant and equipment and intangible assets should be tested for impairment if, and only if, there is an impairment indicator.

6.4.2 An entity should assess at each reporting date whether there is any indication that an asset may be impaired. If any indication exists the entity should estimate the asset's recoverable amount. The recoverable amount should be compared with the asset's carrying value and if an impairment loss has arisen it should be recognised immediately.

6.4.3 Goodwill and intangible assets that are deemed to have an indefinite useful life are tested annually for impairment (irrespective of indicators).

6.4.4 Intangibles that are not yet ready for use must also be tested annually because they are not being amortised. The ability of an intangible asset to generate sufficient future economic benefits to recover its carrying amount is usually more uncertain before it is brought into use.

6.5 Impairment indicators

6.5.1 In assessing whether there is any indication that an asset may be impaired an entity should consider at least the following indicators:

External sources of information, including:

- A decline in the asset's market value that is significantly greater than would be expected as a result of the passage of time or normal use. Changes in market values reflect economic conditions, hence a significant fall in value is worthy of further investigation (at least to consider whether it is relevant) as it could be a symptom of another

more pervasive change, for example technological change or a change in demand for the asset's output.

- Significant adverse changes that have taken place or are expected in the near future in the technological, market, economic or legal environment in which the entity operates or in its markets.

- Increases in interest rates or other market rates of return that may materially affect the discount rate used in calculating the asset's recoverable amount.

Internal sources of information, including:

- Obsolescence or physical damage affecting the asset.

- Significant adverse changes that have taken place or are expected in the near future in the extent to which, or in the way that, an asset is used or expected to be used. This includes the asset becoming idle, plans to discontinue or restructure the operation to which the asset belongs or the asset's disposal. It also includes reassessing the asset's useful life from indefinite to finite.

- Deterioration in the expected level of the asset's performance.

6.5.2 An indication of impairment does not necessarily mean there has been impairment. However, if there is an indication that an asset may be impaired the standard notes that the useful life, the depreciation method or the residual value for the asset need to be reviewed and adjusted if necessary under the appropriate IFRS (for example, IAS 16, 'Property, plant and equipment' or IAS 38, 'Intangible Assets'). This applies even if no impairment loss is recognised for the asset.

6.5.3 Post balance-sheet events may provide indications that an asset was impaired at the year end. However, if the event indicates that the impairment occurred after the year end the indicator is not taken into account.

6.6 Loss of economic benefits

6.6.1 IAS 36 makes no distinction between impairments that were clearly caused by the consumption of economic benefits and other impairments. However this has been adapted by the FReM such that only those impairment losses that do not result from a loss of economic value or service potential should be taken to the revaluation reserve (see FReM 8.2.4).

6.6.2 Indications of possible impairment are described in section 6.5 above. Where a newly constructed asset is brought into use and the subsequent valuation is less than cost, the write down may also be described as impairment.

6.6.3 Where there is evidence of obsolescence or physical damage to the asset, valuation will be required to determine the reduction in the service potential of that asset.

6.6.4 Where there is a commitment by management to undertake a significant reorganisation and non-current assets are involved, the impact of potential future impairments arising should be estimated.

6.6.5 In the case of any impairment due (i.e. write down to loss of economic benefits recoverable amount) in the above circumstances will be charged to the Statement of Comprehensive Net Expenditure.

6.6.6 In the case of the above, the recoverable amount will be the asset's net realisable value (i.e. the amount at which the asset could be disposed of, less any disposal costs) or the value of the asset in alternative use.

6.7 Impairment charges to revaluation reserves

6.7.1 Downward revaluation and impairment are written off against the revaluation reserve to the extent that a revaluation surplus exists for that asset, until the carrying value reaches the level of depreciated historical cost (for this purpose, 'historical cost' means the value at which an asset was taken on to the fixed asset register if no historical cost information is otherwise available.) The effect of this is that the write-off should only be made against that proportion of the credit balance on the reserve which relates to the asset concerned. Downward revaluation or impairment below this should be recognised in the Statement of Comprehensive Net Expenditure. This only relates to impairment losses that do not arise from a loss of economic value or service potential. Impairment losses that arise from a clear consumption of economic benefit should not be taken to the revaluation reserve. Negative balances on the revaluation reserve, even if these would be considered temporary in nature, are not permitted under IFRS.

6.8 Recognition of impairment losses

6.8.1 As in the application of all International Financial Reporting Standards, impairment losses need only be recognised (i.e. accounted for) when they are material. What is material in a particular set of circumstances is a matter to be agreed with auditors.

6.8.2 For assets that are carried at valuation an impairment loss is treated as a revaluation decrease. The loss is first set against any revaluation surplus relating to the asset in reserves to the extent of the surplus and the balance of the loss is then treated as an expense in the Statement of Comprehensive Net Expenditure.

6.8.3 Where the amount of an impairment loss exceeds the carrying amount of the asset to which it relates an entity should write the asset down to zero.

The balance of the impairment loss should be recognised in the Statement of Comprehensive Net Expenditure.

6.8.4 When an asset has been impaired, the remaining carrying value less residual value (if any) should be amortised over the remaining useful economic life. The principle in accounting for non-current assets is that asset lives and residual values should be reviewed at least annually to ensure they are realistic and be revised if this is not the case in the light of experience or changed circumstances. An impairment would warrant particular attention, because it may indicate that previously estimated asset lives are unrealistically long and need to be shortened.

6.9 Presentation of impairment losses

6.9.1 Impairment losses should be recognised in the Statement of Comprehensive Net Expenditure, however, an impairment loss on a revaluated asset is recognised against any revaluation surplus first, and only in the Statement of Comprehensive Net Expenditure if it exceeds the revaluation surplus relating to that asset (subject to 6.7.1 above).

6.9.2 In the notes to the financial statements, the impairment loss should be treated as follows:

(a) For assets held on historical cost basis, the impairment loss should be included within cumulative depreciation: the cost of the asset should not be reduced.

(b) For revalued assets held at market value (e.g. existing use value or open market value), the impairment loss should be included within the revalued carrying amount.

(c) For revalued assets held at depreciated replacement cost, an impairment loss should be included within cumulative depreciation; the revalued cost of the asset should not be reduced.

6.10 Revaluation Reserve

6.10.1 The treatment above requires knowledge of Revaluation Reserve balances. The definition of 'an asset' in the context of revaluation reserve apportionment and impairment calculations is sometimes not clear-cut. For properties, land and buildings consist of separate component assets for these purposes.

6.10.2 It is important to be able to relate balances taken to the Revaluation Reserve with their associated assets. When an asset is disposed of, the balance on the Revaluation Reserve in respect of it should be transferred to the General Fund.

6.11 Donated assets and assets financed by Government Grant.

6.11.1 These are now treated in same manner as described above. There is no longer a separate Donated Asset or Government Grant Reserve.

6.12 Reversal of past impairments

6.12.1 IAS 36 requires that an entity should assess at each reporting date whether there is any indication that an impairment loss recognised in a previous period for an asset (other than goodwill) either no longer exists or has decreased. If there is any such indication the entity should estimate the recoverable amount.

6.12.2 A reversal of an impairment loss should be recognised in the Statement of Comprehensive Net Expenditure to the extent that the original impairment loss (adjusted for subsequent depreciation) was recognised in the Statement of Comprehensive Net Expenditure. Any remaining balance of the reversal of an impairment should be recognised in the revaluation reserve.

6.12.3 Events and circumstances which are the reverse of those listed in 6.5 above as indications of impairment may indicate that the recoverable amount of an asset has increased. An increase in the value of an asset above the amount at which it would have been carried if the original impairment not taken place is a revaluation and should be presented as such.

6.13 Impairments that score as DEL and Annually Managed Expenditure (AME) (Core and non-core RRL)

6.13.1 In order to provide support for NHS Boards' asset management and estate rationalisation programmes, impairments are split into six different categories, some of which should be included in the charge against the RRL and others which should not. The definition of the categories of impairments included in the FReM to score as AME (non-core RRL) should be deducted from the charge against the core RRL and boards should contact the SGHSCD to agree eligible impairments to SGHSCD to agree them. These are also noted below as follows:

6.13.2 ***Loss as a result of a catastrophe***. Damage to non current assets as a result of a catastrophe. Such events are very rare in global terms and exceptionally rare in the UK. These events are so rare as to be generally easy to identify. They include major earthquakes, volcanic eruptions, tidal waves, exceptionally severe hurricanes, droughts and other natural disasters; acts of war, riots and other political events; and technological accidents such as major toxic spills or release of radioactive particles into the air. For the avoidance of doubt, the following are not catastrophes within the meaning of this definition: Prison or street riots; loss or damage due, for example, to an ingress of water that could have been avoided by better maintenance; and relocation to a site where flooding is likely. These are all examples of losses resulting from management action or inaction.

6.13.3 ***Unforeseen obsolescence***, occurring either as the result of the introduction of a completely new technology or a change in legislation rendering the asset illegal. Such events are expected to be exceptionally rare for Health Boards. All assets are subject to obsolescence. However, the rate of obsolescence tends to be category specific: e.g. IT assets suffer a faster rate of obsolescence than do buildings. Departments will take account of foreseeable obsolescence when establishing asset lives.

6.13.4 Other eligible impairments that cannot be classified in any of the other impairment categories including the following:

- ***write down to depreciated replacement cost*** where specialised building assets or enhancements (e.g. the construction of a new wing or capitalised refurbishment) to such assets are written down to depreciated replacement cost (DRC) following the first professional valuation after completion of the work,

- ***write downs of developed land*** where land is purchased for some form of social development and the cost of the land and any clean up is greater than the disposal value,

- ***changes in use*** where specialised assets no longer required for their original purpose are put to a non specialised use (e.g. building constructed for specialised purpose currently used as a store) or where an asset becomes permanently underused. However, impairment can result from the change of use of any asset including non-specialised assets,

- **surplus assets** -***disposals*** where assets are identified as surplus to requirement and are planned to be disposed of,

- ***uncompensated seizures*** of assets by governments or institutional units, other than for the settlement of fines or taxes, for which full compensation is not provided.

6.13.5 Categories of impairment included in the FReM to score as DEL normally remain within the charge against the RRL and boards are expected to fund these from within their own resources. As part of the 2013/14 Budget Bill, the Health and Wellbeing resource budget now includes a "non-cash " budget that could provide funding for DEL Impairments. Boards should identify any funding they may require from this non-cash DEL budget and submit to the Scottish Government Health & Social Care Directorate for consideration. Types of impairment that can be considered under this category include:

- ***Abandonment of assets in the course of construction*** as a result of a management decision to abandon the construction process, i.e. management decides that it no longer requires the facility under construction and the construction costs to date are completely written off or substantially written off to reflect reduced utility. This category

includes the abandonment of software assets in the course of construction.

- ***The unnecessary over-specification of assets (gold-plating)*** at the point at which the asset is first constructed or purchased. This category should be used where the over-specification of assets leads to an impairment either because the asset is valued at its utility value to the business, or because the over-specification cannot be reflected in the recoverable amount. Care should be taken not to impair assets as being gold plated where they are of a high specification by necessity. For example, the high specification of embassies is in part a result of security and other factors relating to location and the needs of a representational building. The higher specification due to justified security and operational considerations should not lead to an impairment down to the value of ordinary office accommodation. The key is that the higher specification must be justifiable: if it is not an impairment should be taken.

- ***Loss or damage resulting from normal business operations.*** All losses of, and damage to, tangible non-current assets that reduce the recoverable amount to below the book value other than those caused by a catastrophe (see above). Normal business operations covers all loss and damage to assets that result from management and staff action (or inaction), and the actions of third parties. This category includes theft.

6.13.6 Any proposed treatment of impairments as deductions from the charge against the RRL will need to be fully supported by forecasts identifying each impairment by the property or asset to which it relates within the relevant categories highlighted above. This will be required as an initial forecast to be submitted to the SGHSCD which should show the maximum deduction that boards expect to make in respect of such impairments in the financial year. These are expected to show for each asset the nature, reasons and amounts of any impairments identified, together with supporting information. This should agree with information that is subsequently submitted in boards' monthly monitoring returns.

6.14 Impairment Forecasting

6.14.1 The SGHSCD will require to know the maximum amount of eligible impairments for the financial year in the monitoring return for the period ending 30 November of that year. This is the final point in the financial year at which SGHSCD can advise of the funding requirement and any increases will therefore have to be managed within that funding.

6.15 Operational surplus properties

6.15.1 Properties that are expected to become surplus but are still operational, should be assessed for compliance with IFRS 5. The functional life adjustments and accelerated depreciation adjustments under UK GAAP do not arise under IFRS.

6.16 Reversal of impairments

6.16.1 The reversal of past impairments through the Statement of Comprehensive Net Expenditure raises the question of handling credits in respect of expenditure that was previously charged. Just as NHS bodies were allowed to exclude the impact of impairments from the charge against the RRL, they cannot gain credit from the recognition of impairment reversals. These reversals should therefore be identified as part of the calculation of the net deduction from the charge against the RRL.

6.17 Accounting entries and examples - Revaluation and indexation and impairment and impairment reversal

6.17.1 Following revaluation the purchase cost and accumulated depreciation elements of non-current assets should be adjusted to reflect any changes in values. IAS 16 allows this to be done either by adjusting the cost and accumulated depreciation elements by an appropriate factor or by eliminating all of the accumulated depreciation to date and reflecting the revalued amount within the revalued cost element in the fixed asset note.

6.17.2 Elimination of accumulated depreciation would only be appropriate in respect of the full professional revaluation that is required every five years and Boards should reflect indexation or interim valuations through adjustments to both the cost and accumulated depreciation. However Boards will also be permitted to reflect full professional valuations in this way if they wish to do so.

6.17.3 On impairment of a revalued asset, the balance on the revaluation reserve in respect of that asset up to the amount of the impairment will become fully realised and should be transferred to the General Fund.

6.17.4 A reversal of an impairment loss should be recognised in the Statement of Comprehensive Net Expenditure to the extent that the original impairment loss (adjusted for subsequent depreciation) was recognised in the Statement of Comprehensive Net Expenditure. Any remaining balances relating to the reversal of an impairment should be recognised in the statement of changes in taxpayers' equity.

6.17.5 The underlying principle in reversing impairments previously charged to the Statement of Comprehensive Net Expenditure is to ensure that the same overall effect is achieved as would have been the case had the original downward revaluation not occurred. In other words, adjustments must be made in respect of the lower depreciation charged to the Statement of Comprehensive Net Expenditure following downwards revaluation. The reversal of the impairment does not necessarily have to stem from the same cause as the original impairment, and the application of upward revaluations may be taken to reverse earlier impairments.

6.18 Assets Under Construction

6.18.1 Assets classified as under construction should be recognised in the balance sheet to the extent that money has been paid or a liability has been incurred.

6.18.2 Construction inefficiencies are not valid costs of building and should not be capitalised – they should be written off directly to the Statement of Comprehensive Net Expenditure (see 2.10.1).

6.18.3 Where indexation is applied to an asset under construction and the costs are subsequently identified as construction inefficiencies, the indexation (or proportion thereof) should be reversed out.

6.18.4 When an asset is transferred from AUC to non-current assets (PPE or intangible assets), if the first valuation after the asset is brought into use results in a fall in value, this write down in valuation should be treated as an impairment, and the impairment should be charged to the Statement of Comprehensive Net Expenditure. Any balance on the revaluation reserve in respect of that asset up to the amount of the impairment will become fully realised and should be transferred to the General Fund.

6.19 Surplus assets

6.19.1 Non-current assets held for sale under IFRS 5 (see section 7) are outwith the scope of IAS 36. A non–current asset classified as held for sale should be measured at the lower of its carrying amount and fair value less costs to sell in accordance with IFRS 5. Immediately before the initial classification of an asset as held for sale, the carrying amount of the asset should be measured in accordance with applicable IFRSs. A plan to dispose of an asset or cash generating unit is an internal indicator of impairment, specifically identified by the standard. In accordance with IFRS 5, prior to classification as held for sale the asset must be reviewed for impairment under IAS 36.

6.19.2 Properties may be identified as surplus significantly in advance of actually becoming surplus, particularly in the case of large hospitals. They should only be treated as surplus when they become available for disposal.

7 Non-current assets held for sale and disposal of non-current assets

7.1 Introduction

7.1.1 IFRS 5, 'Non-current assets held for sale and discontinued operations' sets out requirements for the classification, measurement and presentation of non-current assets held for sale. There is no equivalent UK standard. Non-current assets that meet the criteria to be classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell, with depreciation on such assets ceasing at the point of reclassification. Non-current assets that meet the criteria are also presented separately on the balance sheet.

7.1.2 The historical requirements under UK GAAP and the FReM were that, where assets are measured at valuation, any assets that become surplus to requirements and earmarked for disposal should be held at Open Market Value. Under IFRS, where assets are earmarked for disposal and meet certain requirements e.g. capable of being sold immediately and the sale being highly probable, they fall within the scope of IFRS 5. Under this standard, the assets are then held at the lower of their carrying value and 'fair value less costs to sell'.

7.1.3 This may have a significant impact for NHS Bodies, due to the fact that most healthcare properties are considered to be specialised and, as noted above, are generally held at DRC. This valuation is likely to be different from the open market value (OMV) of the site depending on market conditions and the relative costs of building specialised properties. Impairments would be recognised in accordance with the guidance in chapter 6 where the OMV is less than the DRC but where it is greater the assets should be held at DRC valuation until they become surplus in terms of the criteria specified below.

7.2 Conditions for classification as held for sale

7.2.1 IFRS 5 describes criteria that must be met before a non-current asset (or disposal group) will be classified as held for sale.

7.2.2 Firstly it must be ***available for sale in its present condition***, allowing for terms that are usual or customary for such assets. Such terms might include, for example, search and surveys of the property. They do not include any conditions that have been imposed by the seller of an asset, for example, if the property is being marketed subject to the vendor obtaining planning permission, the property is not available for immediate sale in its present condition, it is being made available by the vendor as a property in a materially different condition (that is including planning permission). Hence the property would not be classified as held for sale.

7.2.3 The second condition for classification of an asset or disposal group as held for sale is that the ***sale must be highly probable***. This is defined in IFFRS 5 as 'significantly more likely than probable', which itself is, 'more likely than not'. The criteria for a sale to be highly probable are:

- the appropriate level of management must be committed to a plan to sell. This means a level of management that has the authority to sell the asset or disposal group; and
- an active programme to locate a buyer and complete the sale must have begun. This will include making it known that the asset or disposal group is for sale to those who might be interested; and
- the asset or disposal group must be actively marketed at a price that is reasonable compared to its current fair value. This should take account of local conditions in the market; and
- the sale should be expected to be recorded as completed within one year from the date of classified as held for sale. This is not approximately within one year or by the end of the following accounting period; and
- finally, the actions required to complete the plan should indicate that it is not likely that there will be significant changes made to the plan or that the plan will be withdrawn.

7.2.4 In certain circumstances a Board can go beyond the one year condition. The sale date may extend beyond one year from the date of classification as held for sale when a delay is caused by events outside the Board's control occurring and there is evidence that the Board is still committed to the sale. IFRS 5 sets out a number of detailed conditions that need to be met if the asset or disposal group is to continue to be classified as held for sale when the one year condition is breached.

- at the date the Board commits itself to a plan to sell the non-current asset or disposal group it has a reasonable expectation that other parties, that are not the buyer, will impose conditions that will extend the period required to complete the sale and i) actions required to meet those conditions cannot begin until a firm purchase commitment is obtained and ii) a firm purchase commitment is highly probable within one year.
- the Board obtains a firm purchase commitment and the buyer or other parties unexpectedly impose conditions on the transfer of a non-current asset or disposal group that has been classified as held for sale that will extend the period required to complete the sale and i) the Board has taken timely actions to respond to the conditions; and ii) a favourable resolution of the factors delaying the sale is expected.

- During the one year period following classification as held for sale, circumstances occur that had previously been thought unlikely to happen and the asset or disposal group is not sold by the end of the year and i) during the initial one year period after classification as held for sale the Board took the necessary action to respond to the change in circumstances; ii) the non-current asset or disposal group is being actively marketed at a reasonable price given the changes in circumstances and the criteria in 7.2.2 and 7.2.3 continue to be met.

7.2.5 Boards cannot classify a non-current asset or disposal group as held for sale if it meets the criteria to be classified as held for sale after the balance sheet date. However, if the criteria are met between the balance sheet date and the date that the financial statements are authorised the Board should provide disclosure in the financial statements.

7.2.6 IFRS 5 deals with assets whose carrying value will be principally recovered through sale rather than through continued use. A non-current asset or disposal group that will be abandoned or scrapped cannot be classified as held for sale.

7.3 Measurement of non-current assets held for sale and disposal groups

7.3.1 A non-current asset or disposal group that has been classified as held for sale should be measured at the lower of:

- its carrying amount; or
- fair value less costs to sell.

Prior to measurement on this basis the non-current asset or the individual assets and liabilities within the disposal group are measured in accordance with applicable standards, for example, IAS 16 and IAS 38 as outlined above.

7.4 Fair value less costs to sell

7.4.1 Fair value is defined as 'the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction'.

7.4.2 Costs to sell are 'the incremental costs directly attributable to the disposal of an asset (or disposal group), excluding finance costs and income tax expense'. Note that costs must be incremental; internal costs cannot be included in costs to sell.

7.4.3 If the sale is expected to occur after one year from initial classification (because the Board is able to satisfy the rules set out in the first bullet in 7.2.4) costs to sell should be measured at their present value (that is discounted). Any increase in the costs to sell over time should be presented in the operating cost statement as a financing cost.

7.5 Measurement prior to classification as held for sale

7.5.1 Assets should be measured in accordance with applicable IFRSs immediately before classification as held for sale. This ensures that any gains, losses or measures of consumption (depreciation and amortisation) are properly taken account of and not rolled up into, or masked by, measurement under IFRS 5.

7.6 Impairment

7.6.1 IAS 36 requires a Board to assess at each ***reporting date*** whether there is an indication that an asset may be impaired and, if any such indication exists, estimate the asset's recoverable amount. In cases where a Board decides to sell an asset or disposal group some time in the future this is an indicator that the asset or disposal group may be impaired. The Board should, therefore, at that time or at the next reporting date, perform an impairment review.

7.6.2 In practical terms, this means that an impairment review will be required before IFRS 5 classification as held for sale only when a Board decided to sell a non current asset or disposal group, but it does not meet the IFRS 5 criteria to be classified as held for sale until after the next reporting date.

7.7 Measurement on classification as held for sale

7.7.1 Following measurement in accordance with applicable accounting standards non-current assets or disposal groups held for sale should be measured at the lower of their carrying amount and fair value less costs to sell.

7.7.2 If the fair value less costs to sell is greater than the carrying value, then no further adjustment is made.

7.7.3 If the fair value less costs to sell is lower than the carrying value an impairment should be recognised on classification as held for sale.

7.8 Re-measurement of non-current assets held for sale

7.8.1 At each reporting date where a non-current asset or disposal group continues to be classified as held for sale it should be re-measured to the lower of its previous carrying value and fair value less costs to sell. Any loss in value of AHFS may be treated as an impairment and included as part of the AME request.

7.9 Depreciation, amortisation and interest

7.9.1 Non-current assets that are classified as held for sale, or are part of disposal groups that are classified as held for sale, should not be depreciated or amortised.

7.10 Changes to a plan to sell

7.10.1 Boards classifying non-current assets or disposal groups as held for sale need to monitor the conditions in 7.2.2 and 7.2.3. If they are not met at any point then the non-current asset or disposal group ceases to be classified as held for sale.

7.11 Measurement on declassification as held for sale

7.11.1 A non-current asset or disposal group that stops being classified as held for sale should be remeasured. This should be at the lower of:

- Its carrying amount prior to the asset or disposal group being classified as held for sale, adjusted for any depreciation, amortisation or revaluation that would have been recognised if the asset or disposal group had not been classified as held for sale.

- Its recoverable amount at the date of the decision not to sell.

7.11.2 Recoverable amount is defined as 'the higher of an asset's fair value less costs to sell and its value in use'.

7.12 Presentation and disclosure

7.12.1 Non-current assets held for sale and the assets and liabilities of disposal groups must be presented separately from other assets and liabilities in the balance sheet.

7.12.2 Any gain or loss on measurement of non-current assets or disposal groups held for sale should be disclosed in the notes to the financial statements.

7.12.3 In the period in which a non-current asset held for sale or disposal group has been classified as held for sale or sold the following should be disclosed:

- A description of the asset or disposal group.

- A description of the facts and circumstances of the sale or those leading to an expected disposal, and the expected method and timing of the disposal.

- Any gain or loss recognised in respect of such assets.

- Where applicable the segment that the non-current asset or disposal group is part of.

7.13 Recognition of gains and losses on disposal

7.13.1 Where a non-current asset is sold (including transfer of ownership), scrapped/demolished, destroyed or otherwise disposed, a final adjustment will be required to reflect the disposal in the accounts, and to take account

of any profit or loss on disposal, if appropriate. The profit or loss may be defined as the difference between net disposal proceeds and net book value.

7.14 Accounting for disposals

7.14.1 The asset should be removed from the balance sheet at net book value as at the end of the period of disposal. The net book value of the disposed asset should be debited to a 'Sale of Asset Account'. The balances for revaluation in respect of assets disposed of in the year should be transferred from the Revaluation Reserve to the General Fund.

7.14.2 The sales proceeds should be credited against the 'Sale of Asset Account' with the resultant profit or loss on disposal (i.e. net balance on the 'Sale of Asset Account') being carried to the operating cost statement.

7.15 Budgeting

7.15.1 The net book value of property, plant and equipment asset disposals will be deducted from expenditure charged against the Capital Resource Limit (CRL). NHS bodies should therefore consider whether their CRL would also be required to be adjusted if they are not able to utilise this to fund capital expenditure in year. Any adjustment required to the CRL should be notified to the SGHSCD. This may result in a situation where the CRL is negative because this capital income is greater than capital expenditure. It should be noted that from 2011-12 onwards, the capital element of receipts will accrue to SGHSCD and will be used to support the overall capital programme, rather than being available directly to Boards as per current practice. Further detail is included within CEL 32 (2010) "Arrangements for the Management of NHS Scotland Capital Resources after 2010-11."

7.15.2 The profit or loss on disposal of property, plant and equipment will be carried to the operating cost statement and shall therefore be included in arriving at the net operating costs.

7.15.3 NHS bodies should not assume that an adjustment will be made to their RRL or CRL for fixed asset transactions. It is the responsibility of the NHS body to inform the SGHSCD of any disposals of fixed assets.

Example 1: Sale of land and buildings by Health Board:

7.15.7 The Health Board sells a building with a net book value of £25k (original cost £200k and accumulated depreciation of £175k). The body receives sales proceeds of £150k and therefore makes a profit on sale of the asset of £125k. The accounting entries would be as follows:

	Sell the asset and receive cash of £150k
Dr	Cash
Cr	Sale of Asset Account
	With sale proceeds of £150k

	Disposal of asset – removal of NBV
Dr	Sale of Asset Account
Cr	Non-current Assets PPE – Cost
	With asset cost of £200k

Dr	Non-current Assets PPE – Accumulated Depreciation
Cr	Sale of Asset Account
	With accumulated depreciation of £175k

The resultant credit of £125k on the Sale of Asset Account should be credited to the operating cost statement as a 'profit on disposal of property, plant and equipment'.

7.16 Timing of Disposal

7.16.1 The timing of disposal of an asset will be determined in accordance with the guidance in section 5.13.1, which will inform the depreciation charge required.

7.16.2 It should be noted that disposal occurs only when an asset is no longer available for use. An asset which has been declared surplus to requirements but is still available for use will still incur depreciation.

7.16.3 A sale of an asset should be recognised when contracts are exchanged or completion takes place. Where uncertainty exists the recognition of sale should be deferred until completion. Recognition is dependent upon the certainty that the transaction will take place.

Transfer of Ownership

7.16.4 Where an asset is transferred between NHS bodies, the body transferring the asset should transfer the net book value of the asset and the balance on the revaluation reserve to the general fund. Conversely, the body acquiring the asset should account for the gross book value, accumulated deprecation and revaluation reserve balance of the asset, with the net credit being made to the general fund.

Calculation of Profit or Loss on Disposal of Assets

7.16.5 The final profit or loss on disposal is calculated by comparing any disposal proceeds, net of any incidental costs of disposal (for example, dismantling or transport costs), with the net book value of the asset at the end of the period.

7.16.6 In the period of disposal, if the asset does not meet the definition of a non-current asset held for sale, depreciation/amortisation should be charged for the whole period as normal and the profit or loss should then be calculated as at the end of the period.

7.16.7 If the asset does meet the definition of a non-current asset held for sale, depreciation and amortisation should cease on classification as a non-current asset held for sale and the asset should be measured at the lower of carrying amount and fair value less costs to sell. In most cases, the fair values of specialised assets held by Boards are likely to exceed their carrying amounts since the former takes into account potential alternate uses. In such situations, an asset held for disposal would therefore continue to be measured at its carrying amount, and this value used to calculate any subsequent profit on disposal.

Example 2: Sale of Equipment by a Health Board

7.16.8 An example of a disposal adjustment is shown below, using the quarterly basis of calculation.

A Health Board has a piece of equipment with a replacement cost of £10,000. At that date is has an accumulated depreciation balance of £6,000. It was sold during the quarter for £500.

Replacement Cost at start of quarter				10,000
Accumulated Depreciation at start of quarter				6,000
Opening Net Book Value				4,000
Depreciation for quarter	=			1,000
NBV after charging depreciation	=	4,000 - 1,000	=	3,000

The adjustment (i.e. net profit/(loss) on sale) can be calculated as:
proceeds less net book value at end of quarter

= 500 - 3,000 = (2,500) i.e. a loss of 2,500

Therefore, total charge to the operating cost statement in quarter of disposal:

Depreciation	1,000
Loss on disposal of fixed asset	2,500
	3,500

8. Leases

8.1 Introduction

8.1.1 In addressing the accounting treatment for leases and hire purchase transactions, IAS 17 Leases sought to ensure that entities account for the substance of any leasing agreement or hire purchase contract, thus improving comparability between companies in terms of gearing and asset rates of return. Further, it was important that the users of financial statements should be able to understand the heavy obligations falling on companies that rely on long-term lease finance.

8.1.2 In the NHS the main impact of IAS 17 is in the area of Capital Charges. The classification of a lease as 'finance' or 'operating' determines whether an asset is recognised in the balance sheet and so attracts Capital Charges and counts as capital expenditure, or is simply a revenue transaction. It is probably the case that this issue gives rise to more queries than any other subject in the Capital Accounting Manual.

8.1.3 IAS 17 needs to be considered alongside SIC 27 Evaluating the substance transactions involving the legal form of a lease, IFRIC 4 Determining whether an arrangement contains a lease, SIC 15 Operating lease incentives, IFRIC 12 Service Concession Arrangements and SIC 29 Service Concession Arrangements:Disclosures. Both the international accounting standard and the interpretations follow the 'substance over form' principle and in complex related transactions (e.g. sale and leaseback, PFI schemes) the nature of the series of transactions needs to be considered as a whole, rather than concentrating on individual transactions.

8.1.4 This is described in sections 6.2.44 to 6.2.65 of the FReM.

8.1.5 Chapter 12 of this manual deals specifically with PFI transactions.

8.2 Leasing arrangements between NHS bodies

8.2.1 To comply with IFRS, it is necessary for NHS bodies to consider the nature of the lease, and treat it as finance or operating as required. The lease should be similarly classified in the books of the lessor and lessee.

Definitions

8.3 Lease

8.3.1 'A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time'.

8.4 Finance lease

8.4.1 A finance lease is a lease 'that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred'.

8.5 Operating lease

8.5.1 An operating lease is 'a lease other than a finance lease'.

8.6 The lease term

8.6.1 The ***lease term*** is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

8.6.2 Generally, the lease period can be divided into primary and secondary terms. In the ***primary lease term*** the lessee is committed to make certain rental payments, with a termination payment sometimes payable on termination of the primary term. The ***secondary lease term*** is that in which the lessee may extend the lease if desired. The secondary term is normally included in the lease term if it is reasonably certain that the lease will so be extended. A ***nominal or peppercorn rent*** in the secondary term may be ignored for the purposes of the minimum lease payment test if it is not material.

8.6.3 It is important, therefore, to consider carefully, those parts of the lease that deal with: the leases non-cancellable period (sometimes referred to as the 'primary period'); cancellation (or 'break') clauses; exchange and upgrade conditions; and options to extend the lease.

8.6.4 A non-cancellable lease is defined by the standard as a lease that is cancellable only:

- upon the occurrence of some remote contingency;
- with the permission of the lessor;
- if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or
- upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.

Break clauses

8.6.5 If a lease contains a clean break clause, that is, where the lessee is free to walk away from the lease agreement after a certain time without penalty,

then the lease term for accounting purposes will normally be the period between the commencement of the lease and the earliest point at which the break option is exercisable by the lessee.

8.6.6 If a lease contains an early termination clause that requires the lessee to make a termination payment to compensate the lessor (sometimes referred to as the 'stipulated loss value') such that the recovery of the lessor's remaining investment in the lease was assured, then the termination clause would normally be disregarded in determining the lease term.

8.6.7 Where there are break clauses that transfer some economic risk to the lessor, but at the same time give the lessor some protection from financial loss, the interpretation becomes more difficult and will be a matter of judgement.

Statutory rights of renewal

8.6.8 Where the terms of renewal are set at what is anticipated to be significantly below a fair market rental then it is reasonable to assume that the lessee will act in his own commercial interests and extend the lease. In these situations, the lease term would include both the minimum period and the renewal period. Where, however, the rentals in the secondary period are based on a fair market basis, such that there is no compelling commercial reason why the lessee must extend the lease, then the lease term will normally exclude the secondary period.

8.6.9 Other factors that may need to be considered in determining whether secondary periods should be included in the lease term are other forms of commercial compulsion such as penalties. For example, if the lessee is subject to a penalty for failing to renew a lease or exercise a purchase option, or if the return conditions stipulated in the lease are unduly penal, it may be to the lessee's advantage to continue to lease the asset. Similarly, if the lessee's business is dependent on the asset such that the cost of its removal and disruption of business are disproportional to the costs of continuing the lease, the secondary period should be included in the lease term.

8.7 Determining the lease type

8.7.1 Under UK GAAP there was a 90% test used when determining whether a lease was a finance lease or an operating lease. Under UK GAAP this test was not definitive and UK GAAP was moving towards more qualitative tests in deciding whether risks and rewards of ownership have been transferred, with the 90% test being just one factor. Under IFRS, IAS 17 does not make any specific judgement on a threshold and provides the following examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease:

- The lease transfers ownership of the asset to the lessee by the end of the lease term.

- The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised.

- The lease term is for the major part of the economic life of the asset even if title is not transferred.

- At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.

- The leased assets are of a specialised nature such that only the lessee can use them without major modifications being made.

8.7.2 In addition to the above, IAS 17 sets out the following situations that individually or in combination could also lead to a finance lease classification:

- If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee.

- Gains or losses from the fluctuation in the residual's fair value fall to the lessee (for example in the form of a rent rebate equalling most of the sales proceeds at the end of the lease).

- The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

8.7.3 ***Economic life*** is either:

(a) the period over which an asset is expected to be economically usable by one or more users; or

(b) the number of production or similar units expected to be obtained from the asset by one or more users.

Generally, the former of these two will apply, as in most cases it is more straightforward to assess useful lives by reference to time periods. However, for some types of asset, usage may be a more reliable measurement. For example, a machine may have the capacity to produce 100,000 units before it wears out. In that case the useful life may be set at 100,000 units. However, if the same machine can produce 20,000 units per year and is expected to operate at its full capacity, a useful life of five years might be used instead.

8.7.4 ***Minimum lease payments*** are the payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:

(a) or a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or

(b) for a lessor, any residual value guaranteed to the lessor by:
(i) the lessee;
(i) the lessee;

(ii) a party related to the lessee; or

(iii) a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.

8.7.5 ***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. In applying the minimum lease payment test, if this value is not known, an estimate may be used.

8.7.6 The ***inception of the lease*** is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date:

(a) a lease is classified as either an operating or a finance lease; and

(b) in the case of a finance lease, the amounts to be recognised at the commencement of the lease term are determined.

8.7.7 In calculating the ***present value of the minimum lease payments***, the discount factor is the interest rate implicit in the lease.

8.7.8 The ***implicit interest rate*** is "...the discount rate that, at the inception of the lease, causes the aggregate present value of (a) the minimum lease payments and (b) the unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset and (ii) any initial direct costs of the lessor".

8.7.9 In more simple terms, the interest rate implicit in the lease is the lessor's internal rate of return from the lease taking into account the normal cash price of the leased asset, rentals and the amount the lessor expects to recover from the residual value. In practice, the interest rate implicit in the lease is unlikely to be stipulated in the agreement and, unless the lessor volunteers the information to the lessee, the lessee will need to derive an estimate of the rate from the information available.

8.7.10 A lessee can normally derive a reasonable estimate of the interest rate implicit in a lease where he either knows, or can make a reasonable estimate of, the cost of the asset and the anticipated residual value of the asset at the end of the lease term. However, where this is not possible, the standard requires the lessee to use his incremental borrowing rate to determine the present value of the minimum lease payments. The lessee's incremental borrowing rate is the rate the lessee would have to pay on a similar lease or, if that is not determinable, the rate at the inception of the lease that the lessee would incur on borrowings over a similar term with a similar security.

8.7.11 As NHS bodies no longer borrow at interest from the Government a rate of incremental borrowing is not readily available. The following value may be used instead:

Treasury discount rate for long-term liabilities

8.7.12 In applying the present value of the minimum lease payment test, NHS bodies and their auditors will need to consider the reliability of fair value, residual value and implicit interest rate figures used. Care must be taken that these values are not manipulated to produce a figure to 'prove' the existence of an operating lease.

8.7.13 If the present value of the minimum lease payments amounts to substantially all the fair value of the leased asset, the agreement can be viewed as a financing arrangement. IAS 17 does not provide a numerical definition of what is meant by "***substantially all***". Instead, judgement should be used to determine when the present value of the minimum lease payments amounts to substantially all the fair value of the leased asset.

8.8 Determining the Lease Type – Other Factors

8.8.1 Responsibility for maintenance, insurance etc can be an indicator, but the fact that a lessor bears these costs is meaningless if he recovers them through rentals.

8.9 Determining whether an arrangement contains a lease

8.9.1 Boards sometimes enter into arrangements that do not take the legal form of a lease, but which nevertheless convey a right to use an asset in return for a payment or series of payments. Examples include:

- Outsourcing arrangements.
- Rights to use capacity in the telecommunications industry.
- Take or pay contracts.

IFRIC 4 provides guidance on when such arrangements are, or contain, leases. If it is determined that an arrangement contains a lease, the lease should be accounted for in accordance with IAS 17. In addition, IFRIC 4

addresses when the assessment or reassessment should be made and how payments for the lease should be separated from payments for other elements of the arrangement.

8.9.2 Under IFRIC 4, determining whether an arrangement is, or contains, a lease is based on the substance of the arrangement, which means assessing if:

- fulfilment of the arrangement is dependent on the use of a specified asset or assets; and
- the arrangement conveys a right to use the asset or assets.

8.9.3 The asset on which fulfilment of the arrangement is dependent need not be explicitly identified by the arrangement's contractual provisions. Rather it may be implicitly specified, because it is not economically feasible or practical for the supplier to fulfil the arrangement using alternative assets. Factors that might impact the assessment of whether it is economically feasible or practical to use alternative assets are, inter alia, the assets' location, the availability of alternative assets, the assets' cost of installation, any interruption to customer service as a result of replacing the assets, whether the replaced assets could be used on other customers and any asset replacement patterns specified in the contract.

8.9.4 An arrangement conveys a right to use an asset if the purchaser (lessee) has the right to control the asset's use. A right to control is conveyed if any of the following conditions are met:

- The purchaser has the ability or right to operate the asset or direct others to operate the asset whilst obtaining or controlling more than an insignificant amount of the asset's output.

- The purchaser has the ability or right to control physical access to the asset whilst obtaining or controlling more than an insignificant amount of the asset's output.

- There is only a remote possibility that parties other than the purchaser will take more than an insignificant amount of the asset's output and the price the purchaser will pay is neither fixed per unit of output nor equal to the current market price at the time of delivery.

8.9.5 Where such a lease is identified, the payments for it should be separated from the rest of the contract (using estimation techniques if necessary) and then accounted for as a finance or operating lease in accordance with IAS 17.

8.9.6 This split is made on the basis of the relative fair values of the lease and the other elements of the arrangement. Where it is impracticable for the purchaser to separate the payments reliably, the purchaser is required:

- In the case of a finance lease, to recognise an asset and liability equal to the fair value of the underlying asset that is the subject of the lease. Interest is accrued on the liability recognised at the purchaser's/lessee's incremental borrowing rate.

- In the case of an operating lease, to treat all payments made under the arrangement as if they were lease payments. Such amounts should be disclosed separately from other arrangements that do not include payments for non-lease elements.

8.9.7 The assessment under IFRIC 4 should be done when the arrangement is first entered into, and should be re-assessed where the contract terms change or where the nature of the underlying asset changes (see 8.9.8 below). However, the IFRIC permits an exemption, which Health Bodies should follow, whereby the assessment can be done based on the contractual conditions applying at the Date of Transition to IFRS i.e. 1 April 2008. Health Bodies should therefore examine their contracts to identify instances where they may be asset-specific. Such contracts may include, for example, payments from one NHS body to another in respect of shared facilities e.g. using buildings, facilities and services on the site of an acute hospital, in return for an annual 'service payment'.

8.9.8 The initial assessment is only revisited if one of the following four conditions are met:

- There is a change in the contractual terms, unless the change only renews or extends the arrangement.

- A renewal option is exercised or an extension is agreed to by the parties to the arrangement, unless the term of the renewal or extension had initially been included in the lease term in accordance with the requirements of IAS 17.

- There is a change in determining whether fulfilment is dependent on a specified asset.

- There is a substantial change to the asset, for example a substantial physical change to property, plant or equipment.

8.10 The substance of transactions with the legal form of a lease

8.10.1 It is also important to consider whether transactions that involve the legal form of a lease do in fact have the substance of a leasing arrangement.

8.10.2 SIC 27, 'Evaluating the substance of transactions involving the legal form of a lease', sets out the required accounting for transactions of the type described above. The basic principle of the SIC is that a series of transactions that involve the legal form of a lease should be accounted for in accordance with their substance. Where the overall economic effect of a series of transactions cannot be understood without reference to the series

of transactions as a whole, the transactions should be accounted as a single transaction.

8.10.3 The SIC sets out the following indicators that individually demonstrate that an arrangement may not, in substance, involve a lease:

- An entity retains all the risks and rewards incident to ownership of the underlying asset and enjoys substantially the same rights to its use as before the arrangement.

- The primary reason for the arrangement is to achieve a particular tax result and does not convey the right to use an asset.

- An option is included on terms that make its exercise almost certain.

8.10.4 Where an entity enters into a transaction similar to the type described in the SIC, the entity retaining use of the asset must determine whether, in substance, it has a separate investment account and lease payment obligation. The principles used in determining whether the entity has an asset and liability are the same as for the recognition of any asset or liability. However, the SIC sets out the following indicators which, when taken together, suggest that the investment account and the lease payment obligations do not meet the definitions of an asset and a liability:

- The entity is not able to control the investment account in pursuit of its own objectives and is not obliged to pay the lease payments.

- The entity has only a remote risk of reimbursing the entire amount of any fee received from the investor. This would be the case if the prepaid amount is required to be invested in risk-free assets, for example, a deposit account with a bank of good credit rating.

- Other than the initial cash flows at inception, the only cash flows expected are the lease payments that are satisfied solely from funds withdrawn from the separate investment account.

8.10.5 The entity retaining use of the asset must also determine an appropriate policy for recognising the fee received from the investing entity as income.

8.11 Property leases

8.11.1 IAS 17 requires that the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification. There are three exceptions to this requirement:

- If the amount that would initially be recognised for the land element is immaterial, the land and the building elements can be treated together for the purpose of lease classification. In such a case, the economic life of the buildings is regarded as the economic life of the whole.

- If title to both the land and the building is expected to pass to the lessee at the end of the lease term, it is likely that both leases will be finance leases, so it will not be necessary to split the leases (although a split between the value of the land and building may be required to arrive at appropriate carrying amounts and depreciation profiles under IAS 16, 'Property, plant and equipment').

- Separate measurement of the land and buildings element is not required when the lessee's interest in both the land and the building is classified as an investment property under IAS 40 as long as the property interest is accounted for as a finance lease and the fair value model is adopted.

8.11.2 The land and building elements of leases should be classified as finance leases or operating leases in the same way as leases of other assets. That is, leases that transfer substantially all the risks and rewards incidental to ownership of the asset are classified as finance leases. All other leases are classified as operating leases. It is not possible to lease a building without also leasing the land on which it stands.

8.11.3 Classifying the ***land element*** of a lease is usually straight forward. Land normally has an indefinite economic life; therefore, unless title to the land is expected to pass to the lessee, the lessee normally does not receive substantially all the risks and rewards of ownership of the land. Consequently, leases of land are normally classified as operating leases. Premiums paid for a leasehold interest in land represent prepaid operating rentals and should be amortised over the lease term in accordance with the pattern of benefits provided. The premium should be treated as a prepayment in the balance sheet, rather than property, plant and equipment. However, prepayments that are not expected to be consumed within an entity's normal operating cycle should be presented as non-current assets in accordance with IAS 1, 'Presentation of financial statements'.

8.11.4 Classifying the ***buildings element*** is often more difficult. However, in many cases it is possible to determine the classification of the lease of the building without performing a detailed split of the rentals between the land element and the building element of the lease. With the exception of the present value test, the criteria for lease classification in paragraphs 10 and 11 of IAS 17 (see 8.7 onwards) can be considered without obtaining a split of the rentals.

8.11.5 For example, a building with a relatively short life, perhaps built to a Board's specification or for a specific use, may well be treated as being held under a finance lease.

8.11.6 Short-term hire of property for a period considerably less than the remaining life, e.g. rental of office or storage space for five years when it has a remaining life of 30 years, may be regarded as an operating lease.

8.11.7 In addition, long leases of a building (usually 99 to 999 years) are likely to be finance leases.

8.11.8 If it is determined that the classification of the land and building elements of the lease are different, the rentals payable under the lease must be split between the two elements. The minimum lease payments (including any up-front lump sum payments) under the lease are allocated between the land and the buildings element in proportion to the relative fair values of the leasehold interests at inception of the lease.

8.12 Accounting for finance leases – lessees

8.12.1 NHS bodies will far more frequently be lessees rather than lessors. Finance lease assets and corresponding liabilities (i.e. finance lease payable) are both included in the balance sheet so the initial effect on net relevant assets should be nil.

8.13 Capitalisation

8.13.1 The leased asset should be first recorded in the lessee NHS body's books and asset register at the commencement of the lease term, the sum to be recognised both as an asset and as a liability should be the fair value of the leased asset or, if lower, the present value of the minimum lease payments each determined at the inception of the lease. In calculating the present value of the minimum lease payments, the discount factor is the interest rate implicit in the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset. It is not appropriate for the liabilities in respect of leased assets to be presented as a deduction from the leased assets as they represent separate assets and liabilities.

8.13.2 Assets and liabilities to be recognised at the commencement of the lease term are determined at the date of inception. The commencement of the lease term is the date from which the lessee is entitled to exercise its right to use the leased asset and it is the date of initial recognition of the lease assets and liabilities. For example, a lessee may sign an agreement to lease a car on 31 March, but does not take delivery of the car until 30 June. The classification of the lease and the measurement of the related assets and liabilities will take place on 31 March, but the recognition in the financial statements of the lease assets and liabilities will not take place until 30 June. Where a contractual commitment is entered into in advance of the commencement date, a disclosure must be made in the Notes to the Accounts.

8.14 Revaluation

8.14.1 Having taken the leased asset onto the balance sheet as noted above, the asset should be revalued before the year end to place it on the same basis as assets owned by the NHS body. Specialised properties will be valued under the DRC basis of valuation, while other assets capable of market valuation will be revalued to fair value.

8.15 Indexation

8.15.1 Leased assets of more than one year should be revalued at the end of each financial year. For assets other than land and buildings this revaluation may be achieved by applying appropriate indexation. Indices supplied by the SGHSCD should be used where they are considered appropriate.

8.16 Depreciation

8.16.1 Assets leased under a finance lease should be depreciated over the shorter of the lease term and its useful life, unless there is a reasonable certainty the lessee will obtain ownership of the asset by the end of the lease term in which case it should be depreciated over its useful life.

8.16.2 IAS 17 defines the ***useful life*** of an asset as the estimated remaining period, from commencement of the lease term, without limitation by the lease term, over which the economic benefits embodied in the asset are expected to be consumed by the entity.

8.16.3 The depreciation policy used should be consistent with that for other depreciable assets that are owned by the entity.

8.16.4 Assets under construction must also be depreciated. This is because the depreciation of a leased asset represents the consumption of the lease rather than of the asset itself. As assets under construction have not yet started their lives, the choice to depreciate over the shorter of the primary lease term and the asset life does not arise; the asset will always be depreciated over the primary lease term.

8.16.5 Land is only treated as a finance lease if title is expected to pass under the lease agreement. In accordance with 8.16.1 above when there is a reasonable certainty the lessee will obtain ownership of the asset by the end of the lease term the asset should be depreciated over its useful life. As land has an infinite life depreciation should not be charged.

8.16.6 The depreciation on leased assets should be charged to the Operating Cost Statement, and is separately identified in the tangible fixed assets note to the Accounts.

8.16.7 Depreciation is charged from the beginning of the period following the date at which the lease is acquired. It is also charged in the period in which the lease expires. Depreciation must be charged even if the asset has been sublet for another purpose, whether at a 'peppercorn' rent or otherwise.

8.16.8 Depreciation will arise on the residual value of an asset during a secondary lease term. This is charged to the Operating Cost Statement as normal.

8.17 Finance lease payable

8.17.1 At the inception of the lease the lessee NHS body will have a financial obligation equal to the present value of the total minimum lease payments or the fair value of the asset. The opening lease payable balance and opening NBV of the leased asset will therefore be equal.

8.17.2 Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The lease payable balance will be reduced each year by the amount of the capital element of the annual rental payment, and must be shown in the Payables note to the Accounts, analysed between payables due within one year and payables due after more than one year.

8.18 Finance charges

8.18.1 The total finance charge is the difference between the total undiscounted minimum lease payments borne by the NHS body over the primary lease term and the capitalised fair value of the leased asset at the inception of the lease. It represents the interest element of the rental payments. This will require to be recalculated annually if using the actuarial method referred to below.

8.18.2 The finance charge should be allocated to accounting periods to produce a constant rate of interest on the outstanding balance for each period, or a close approximation. There are three methods of doing this:

(1) **Straight-line Method**

This is the simplest, but least accurate, method and is only likely to be appropriate for low value, short term leases. It involves calculating the total finance charge for the term of the lease, and apportioning this on a straight-line basis over the full lease term. For example, if the total rental payments for a 10 year lease are £20,000 and the fair value at the inception of the lease is £15,000, then the total finance charge is £5,000, or £500 per year.

(2) **Sum of Digits (Rule of 78) Method**

For longer leases, this approach gives a closer approximation for the rate of interest than the straight line method. It involves establishing, at the inception of the lease, the number of rentals that are payable and calculating the sum of the digits. For example, if there are 10 rental payments then the sum of the digits is 1+2+3+4+5+6+7+8+9+10 = 55. For long lease periods it is best to use the following formula:

sum of digits = (n (n+1))/2

where n is the number of rentals. The finance charge can then be allocated to accounting periods using the following formula:
Number of rentals remaining/total number of rentals x Total finance charge = Finance charge for period

For example, in the first year the finance charge will be (10/55) x £5,000 = £909, in the following year it will be (9/55) x £5,000 = £818, and so on. This assumes that the rental payments are made in arrears. If the payments are made in advance of the accounting period to which they relate, then the sum of the digits at the inception of the lease in the example will be 45. The finance charge in the first year will be (9/45) x £5,000 = £1,000 and so on, and no finance charge will arise in the final year of the lease term.

(3) **The Actuarial Method**

For significant long term leases, the actuarial method should be considered, please contract SGHSCD for further guidance. This is the most accurate method, but involves more complex calculations and it is suggested that it should only be used if a material difference from the sum of digits result is expected. NHS bodies are advised to refer to FLA SORP for an explanation of this method of apportioning finance charges to accounting periods.

8.19 Asset and lease payable

8.19.1 The rental payment to the lessor consists of a capital element and an interest element, the finance charge, representing the lessor's return from leasing out its asset.

8.19.2 The NBV and lease payable balance will only match when the lease is first taken out. Subsequently there will be a mismatch because:

(1) Annual indexation and periodic revaluation will affect the net book value of the asset, but will not affect the annual rental payments;

(2) Depreciation does not commence until the quarter following acquisition of the asset, whereas lease payments and hence the reduction in the capital liability may commence before this;

(3) If the actuarial or sum-of-the-digits methods of allocating finance charges are used, the finance charge will not simply be the rental payment less the depreciation for a period.

8.19.3 Because of the mismatch the depreciation charge in a period does not represent the capital element of the rental. The capital element must be calculated as the total rental payment for the period minus the interest element (i.e. the finance charge). The finance charge is the same in each period if the straight-line method of apportionment is used.

8.20 Improvements to leased assets

8.20.1 Normal repair and maintenance expenditure on a leased asset should be charged to revenue. Expenditure can be capitalised where it involves renovation or upgrading when it is probable the future economic benefits associated with the subsequent expenditure will flow to the entity. The subsequent expenditure should be capitalised and treated as a separate, purchased asset. This applies equally to operating and finance leases, even though under an operating lease the original leased asset was not capitalised. Depreciation on the 'subsequent expenditure' asset is charged to the Operating Cost Statement and the asset is included in average relevant net assets when calculating the rate of return. The life of the improvements will be the shorter of the remaining primary lease term and the assessed life of the improvement. On reversion of the original asset to the lessor the improvements should be treated as a disposal. Subsequent expenditure is discussed in more detail in Section 2.5 of this Manual.

8.20.2 Contractual variations in lease contracts may require additional assets to be created or increase the value of the overall leased asset to be accounted for. These should therefore be assessed in terms of IAS 17.

8.21 Termination of lease

8.21.1 Early termination of a finance lease can be considered as a disposal of the capitalised asset by the lessee if the asset reverts to the lessor. In this case a profit or loss on disposal may arise. Profit/loss on disposal is calculated by comparing the net book value of the asset, less the outstanding lease payable, with any final cash settlement.

8.22 Accounting for Operating Leases – lessees

8.22.1 Operating leases should not be capitalised. Lease payments made under operating leases should be recognised as an expense on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern of the user's benefit.

8.22.2 The requirement to spread the lease rentals on a straight-line basis over the lease term applies even if the payments are not made on such a basis. This also applies where the lessee is not using the leased asset.

8.23 Operating lease incentives

8.23.1 Accounting for operating lease rentals is straightforward. One complication concerns the use of 'operating lease incentives'. In negotiating a new or renewed operating lease, a lessor may provide incentives for the lessee to enter into the agreement. Examples of such incentives are an up-front cash payment to the lessee; the reimbursement or assumption by the lessor of costs of the lessee (such as relocation costs, and costs associated with a pre-existing lease commitment of the lessee); and the gift of an asset such as the lessor bearing directly all the costs of the fitting out the property to the lessee's specifications. Alternatively, initial periods of the lease term may be agreed to be rent-free or at a reduced rent.

8.23.2 SIC 15 addresses the issue. The consensus treatment is that the lessee should recognise the aggregate benefit of incentives as a reduction of rental expense on a straight-line basis, unless another more systematic is representative of the time pattern of the lessee's benefit from the use of the leased asset. It should be noted that the accounting treatment required by SIC 15 is different to that required by UK GAAP, as UITF 28 requires that the benefit should be allocated over the shorter of the lease term and a period ending on a date from which it is expected the prevailing market rental will be payable.

8.24 RRL/CRL Treatment for Leases

8.24.1 Leased assets that are capitalised on balance sheet will be part of additions to fixed assets that determine capital expenditure to be charged against the CRL. Additionally depreciation and finance charges will be part of the expenditure in the operating cost statement to be charged against the RRL.

8.25 Accounting for leases – lessors

8.25.1 NHS bodies will more frequently be lessees than lessors, although a NHS body may lease out an asset that it owns to another body. This could be another NHS body or a private organisation or individual.

8.25.2 For operating leases, the asset will be shown in the NHS body's books and asset register at its full value, i.e. the value is not reduced to reflect the lease. The asset will be depreciated/amortised on a basis consistent with the lessor's normal policy for similar assets and included in 'average relevant net assets'.

8.25.3 Lease income from ***operating lease*** (excluding receipts for services provided such as insurance or maintenance) should be recognised on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished, irrespective of when the payments are due.

8.25.4 Exceptionally, where existing occupiers (e.g. agricultural tenants and some occupiers of dwelling houses) became entitled to security of tenure under

the relevant Acts, following the removal of crown immunity, the value of the NHS body's freehold interest will be assessed, by the appointed Valuer, to reflect the existence of the tenancies.

8.25.5 In certain cases where leasehold agreements have resulted in full risks and rewards of ownership being transferred by the lessor NHS body, the lease may be treated as a finance lease. In such cases, the NHS body that granted the lease should not continue to record the asset as an operational fixed asset within its accounts and will not have to pay depreciation/amortisation or recognise a rate of return on the asset.

8.25.6 The amount due from the lessee under a finance lease should be recognised in the lessor's balance sheet as a receivable at an amount equal to the lessor's net investment in the lease. A lessor's net investment in a lease is its gross investment in the lease discounted at the interest rate implicit in the lease. The gross investment in the lease is equal to the minimum lease payments plus any unguaranteed residual accruing to the lessor. The definition of minimum lease payments is set out in chapter 8.7.4.

8.25.7 Over the lease term, rentals are apportioned between a reduction in the net investment in the lease and finance income. IAS 17 requires that the recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment (before tax). This method of recognising finance income differs from UK GAAP where SSAP 21 requires finance income to be allocated so as to produce a constant rate of return on the net cash investment in the lease (after tax). In practice few Board's are subject to taxation, so the impact of this is likely to be limited.

8.25.8 Any residual payments, accruing to the lessor after full consideration has been received (e.g. from ground rent) should be accounted for as miscellaneous revenue income. In essence, the transaction is accounted for as a sale or disposal.

8.25.9 In cases where NHS bodies lease out assets at low or peppercorn rent, there is a net cost to the NHS. NHS bodies are required to weigh this cost (which includes the depreciation on the asset) against the overall benefits received from the lessee. These benefits may be of a non-financial nature.

8.26 Hire purchase contracts

8.26.1 In the UK there is normally no provision in a lease contract for legal title to the leased asset to pass to the lessee during the lease term. However, under a hire purchase contract the lessee may acquire legal title by exercising an option to purchase the asset upon fulfilment of certain conditions. The precise conditions of a hire purchase contract may vary, but normally when an asset is purchased in this way the legal title does not pass to the purchaser until every instalment has been paid and a small amount, usually included in the last payment, is paid which legally exercises an option to buy the asset. In other words, to buy on hire

purchase is to legally hire the asset until a certain time, when an option can be exercised to take over the legal title to the asset. The hire purchaser is not normally compelled to complete the transaction, and may return the goods and not pay any further instalments. They will, however, forfeit the right to have any of the previous instalments repaid to them. The accounting treatment for a hire purchase contract will be basically the same as for a finance lease, but the final payment to acquire legal title must be included when calculating the present value of the rental payments.

8.27 Accounting entries for finance leases

8.27.1

Capitalisation of leased asset

Dr	Non-current asset (PPE or intangible asset)
Cr	Payables
	With the fair value (or if lower the present value of minimum lease payments)

Depreciation of leased asset

Dr	Operating Cost Statement
Cr	Provision for depreciation account
	With depreciation for period (based on shorter of primary lease period or assessed life)

Payment of rental to lessor

Dr	Payables
Cr	Cash/bank
	With the capital element of rental payment

Dr	Finance charges
Cr	Cash/bank
	With the finance charge element of rental payment

Revaluation of leased assets

Dr	Non-current asset (PPE or intangible asset)
Cr	Provision for depreciation account
Cr	Revaluation reserve
	With net increase in value (no adjustment of finance lease payable)

Expiry of lease

Dr	Provision for depreciation
Cr	Non-current asset (PPE or intangible asset)
	With accumulated depreciation – sets NBV to zero as asset has been fully depreciated over the lease term.

Continuation of lease after primary lease term

Dr	Non-current assets
Cr	Revaluation reserve
	With residual value, calculated or on valuation.

Depreciation in secondary lease term

Dr	Operating Cost Statement
Cr	Provision for depreciation account
Dr	Revaluation reserve
Cr	General Fund
	With depreciation for the period.

Rental payment in secondary lease term

Dr	Operating Cost Statement
Cr	Cash/bank
	With total rental payment (all finance charge as capital element now fully discharged).

Example 1: Finance Lease – Example Calculations

8.27.2 Lease of equipment for 10 years. Assessed life is 15 years. Depreciate over 10 years. Rental payments are £2,000 per annum or £20,000 total. Fair value at inception of the lease is £15,000. The total finance charge is therefore £5,000 and is apportioned using the sum of digits method.

Asset Value Movements in Year	**£**	**Lease payable Movements in Year**	**£**	**Fin. Lease Obligations at Balance Sheet Date**	**£**
YEAR 1					
Opening FV	15000	Opening amount payable	15000	Within 1 Year	2000
Revaluation	600	Total Rental Payment	2000	Between 1 and 5 years	10000
Closing FV	15600	Finance Charge	(909)	After 5 Years	6000
Opening AD	0	Capital Repayment	(1091)	Subtotal	18000
Revaluation	(60)	Closing amount payable	13909	Future Finance Charges	(4091)
Depn. Of FV	(1500)			Outstanding Obligation	13909
Closing AD	(1560)				
Closing NBV	14040				

YEAR 2					
Opening FV	15600	Opening amount payable	13909	Within 1 Year	2000
Revaluation 5%	780	Total Rental Payment	2000	Between 1 and 5 years	10000
Closing FV	16380	Finance Charge	(818)	After 5 Years	4000
Opening AD	(1560)	Capital Repayment	(1182)	Subtotal	16000
Revaluation	(156)	Closing amount payable	12727	Future Finance Charges	(3273)
Depn. Of FV	(1560)			Outstanding Obligation	12727
Closing AD	(3276)				
Closing NBV	13104				

YEAR 3					
Opening FV	16380	Opening amount payable	12727	Within 1 Year	2000
Revaluation	828	Total Rental Payment	2000	Between 1 and 5 years	10000
Closing FV	17208	Finance Charge	(727)	After 5 Years	2000
Opening AD	(3276)	Capital Repayment	(1273)	Subtotal	14000
Revaluation	(247)	Closing amount payable	11454	Future Finance Charges	(2546)
Depn. Of FV	(1638)			Outstanding Obligation	11454
Closing AD	(5161)				
Closing NBV	12047				
					Etc.

9. Capital Charges

9.1 Introduction

Capital charges

9.1.1 For NHS bodies in Scotland, capital charges are taken to mean depreciation and amortisation charged annually to the Statement of Comprehensive Net Expenditure (SOCNE).

9.1.2 Depreciation and amortisation are dealt with in Chapter 5.

9.1.3 The Cost of Capital Charge (previously 3.5% payable on relevant net asets) was removed from the Capital Charge calculation from 1st April 2010.

9.2 Non Core Revenue Expenditure Returns

9.2.1 The SGHSCD requires all health bodies to submit estimates of the financial impact of property transactions and capital charges each year within their Financial Performance Return (FPR). They will also request an annual five year forecast of non-cash expenditure inclusive of depreciation and amortisation.

9.2.2 These estimates are a useful budgetary tool for the service and are collected by the SGHSCD for information to assess the potential impact on the Health Budget for the current and forthcoming years.

10. Donated Assets

10.1 Introduction

10.1.1 This chapter gives more detail on accounting for the acquisition, depreciation and disposal of donated assets.

10.1.2 Assets donated by third parties, either by way of a gift or by way of funds to acquire the asset, should be capitalised at fair value on receipt, provided they meet the criteria in 10.1.5 below. Where the value of the services provided by the asset will be less than fair value because the asset is over specified for its intended use, the lower value should be used.

10.1.3 Donated assets should be revalued, depreciated/amortised and subject to impairment in the same way as other non-current assets.

10.1.4 Where a donor contributes part of the cost of a non-current asset, only that proportion will be accounted for in the way described above. Where a donation is part of a group or series of transactions designed to achieve an overall commercial effect, the substance should be reflected in the NHS Board's accounts.

10.1.5 To qualify to be treated as a donated asset there should be no consideration given in return. Assets which do not meet this criterion should be accounted for in accordance with IAS 16 in the same way as other assets of that general type.

10.1.6 The following examples will not qualify as donated assets:

- assets financed by CRL or government grant;
- assets constructed or contributed to by a developer to benefit the developer's business.

These types of assets should be accounted for in accordance with IAS 16 in the same way as other assets of that general type.

10.1.7 Where a donor imposes restrictions on the use of a donated asset details of the restriction should be disclosed in a note to the financial statements.

10.2 Accounting for donated assets and similar financing from Non-Government Sources

Capitalisation

10.2.1 The provisions in Chapters 2 to 6 of this manual apply: essentially, donated assets are valued on precisely the same basis as purchased assets; being capitalised at fair value and subsequently carried at DRC or fair valuation as appropriate, subject to depreciation/amortisation and impairment. It is necessary to be able to identify donated assets separately from purchased, to enable depreciation/amortisation and impairments to be correctly funded.

10.2.2 Assets provided from National Lottery funds are to be treated as donated.

10.3 Revenue expenditure

10.3.1 Where an asset donation falls below the normal capitalisation threshold, the accounting treatment is to record both income and expenditure, the expenditure being the value of the items received but not capitalised. No entries are made to the revaluation reserve or to the property, plant and equipment or intangible assets note.

10.4 Improvements to donated assets

10.4.1 The normal rules on the capitalisation of subsequent expenditure, and the charging of repairs and maintenance to revenue expenditure, apply. Capitalised expenditure has the effect of creating a part-purchased and part-donated asset. The purchased element should be separately identified and will attract capital charges in the normal manner.

10.5 Consolidation of Endowment and Host Board Accounts

10.5.1 With effect from financial year 2013-14 NHS Boards are required to consolidate Endowment charities and Host Board Accounts. Boards should review their accounting policies for Endowments to ensure that like items are treated in a similar manner across the consolidated group (i.e Board and the linked charity).

Further information in relation to the consolidation of host board and endowment accounts is available in the Annual Accounts Manual.

10.5.2 A particular example which Boards may need to consider is the treatment of property, plant and equipment. NHS Boards have traditionally valued at current replacement cost value and that has not necessarily been the case for Endowments (where historical cost values may have been used). NHS Boards should consider if a change a change in policy and or valuation of such within Endowments will be required to prepare their consolidated balance sheet.

10.6 Acquisition of New Donated Assets

The funding element should be recognised as income and taken through the SOCNE.

Dr: Non Current Donated Asset
Cr: SOCNE Donated income

The debit to Non Current Assets is included in capital expenditure in the annual accounts note 9 'Analysis of Capital Expenditure'. There is no impact on the outturn against the CRL, as a nominal entry is included in this note to reverse the full impact to the net capital expenditure. This is an adjustment on the face of the template rather than an additional entry in the general ledger.

The credit to SOCNE income is removed from the net operating costs in the Summary of Resource Outturn (SORO), to prevent any budgetary impact as a result of the accounting treatment of donated assets. This figure should also be shown as below the line on the monthly monitoring return.

10.7 Depreciation of Donated Asset

The depreciation entries for donated assets are the same as those for purchased non current assets:

Dr: SOCNE Depreciation Charge
Cr: Non Current Donated Asset Accumulated Depreciation

The depreciation charge to the SOCNE is now funded by an AME allocation.

10.8 Revaluation (Upward Price Change) of Donated Assets

Revaluation entries for donated assets are the same as those for purchased non current assets:

Dr: Non Current Donated Assets with net increase in value
Cr: Revaluation Reserve

As for purchased non current assets, the historic cost adjustment should be calculated and transferred between the revaluation reserve and the general fund. More details are included in chapter 5.

10.9 Impairment of Donated Assets

Revaluation entries for donated assets are the same as those for purchased assets:

Dr: SOCNE (AME Funded) with fall in value after revaluation reserve has been utilised for general price changes and with full amount if clear consumption of economic benefits.

Dr: Revaluation Reserve
Cr: Non Current Donated Assets

Any impairment should initially be deducted from any existing revaluation reserve relating to that donated asset and after that be charged to the SOCNE (AME funded).

Impairments can occur where assets are moved from 'in use' to 'available for sale'. Assets available for sale should be held at fair value but any loss at point of sale is an operating cost.

10.10 Disposal of Donated Asset

This will be like any other asset disposal, the NBV will be treated as capital income, through a nominal entry on the face of Note 9 to the accounts. The profit or loss will be charged against the Board's RRL in the SOCNE.

Dr: Cash (sales proceeds)
Cr: Asset disposals account

Dr: Asset Disposals Account
Cr: Non Current Donated Assets

Dr: Asset disposals account (profit on disposal)
Cr: SOCNE

The entries reverse for a loss on disposal.

10.11 Donated Assets with Conditions Attached

The option to defer grant income relating to an asset is restricted to income where the funder imposes a condition. Where assets are financed by donation, the funding element is recognised as income and taken through the SOCNE. To defer this income, a condition imposed by the donor must be a requirement that the future economic benefits embodied in the grant/donation are consumed as specified by the donor, or must be returned to them, e.g. a donation that is conditional on the construction of an asset.

A donated asset may be received subject to a condition that it be returned to the transferor if a specified future event does or does not occur. In these cases, a return obligation does not arise until such time as it is expected that the condition will be breached and a liability is not recognised until that time. Such conditions do not prevent the donated asset being recognised as Income in the SOCNE.

Table 1

	SOCNE Income		Donated Asset Net Book Value		SOCNE Depreciation Charge		Revaluation Reserve		General Fund		Disposal Account		Cash		SOCNE Profit on Disposal	
Year 1	**B/F 0**		**B/F 0**		**B/F 0**		**B/F 0**		**B/F 0**		**B/F 0**		**B/F 0**		**B/F 0**	
Donation of an asset initially recognised at £100k		£100k	£100k													
Depreciation (straight line over 5 year life)				£20k	£20k											
Revalued on 31st March to £90k with a life of 4 years			£10k					£10k								
Net Operating Costs transferred to General Fund at year end	£100k					£20k				£80k						
	C/F 0		**C/F £90k**		**C/F 0**			**C/F £10k**		**C/F £80k**		**C/F £0k**		**C/F £0k**		**C/F £0k**
Year 2	**B/F 0**		**B/F £90k**		**B/F 0**			**B/F £10k**		**B/F £80k**		**B/F £0k**		**B/F £0k**		**B/F £0k**
Depreciation (straight line over 4 year life)				£22.5k	£22.5k											
Historic Cost Adjustment (straight line over 4 year life)							£2.5k			£2.5k						
Net Operating Costs transferred to General Fund at year end						£22.5k			£22.5k							
	C/F 0		**C/F £67.5k**		**C/F 0**			**C/F £7.5k**		**C/F £60k**		**C/F £0k**		**C/F £0k**		**C/F £0k**
Year 3	**B/F 0**		**B/F £67.5k**		**B/F 0**			**B/F £7.5k**		**B/F £60k**		**B/F £0k**		**B/F £0k**		**B/F £0k**
Depreciation (straight line over 3 year remaining life)				£22.5k	£22.5k											
Historic Cost Adjustment (straight line over 3 year remaining life)							£2.5k			£2.5k						
Impaired at 31st March to £42k				£3k			£3k									
Net Operating Costs transferred to General Fund at year end						£22.5k			£22.5k							
	C/F 0		**C/F £42k**		**C/F 0**			**C/F £2k**		**C/F £40k**		**C/F £0k**		**C/F £0k**		**C/F £0k**
Year 4	**B/F 0**		**B/F £42k**		**B/F 0**			**B/F £2k**		**B/F £40k**		**B/F £0k**		**B/F £0k**		**B/F £0k**
Depreciation (straight line over 2 year remaining life)				£21k	£21k											
Historic Cost Adjustment (straight line over 2 year remaining life)							£1k			£1k						
Sold for Proceeds of £25k												£25k	£25k			
Dispose of donated asset				£21k							£21k					
Transfer profit/ loss to SOCNE											£4k					£4k
Transfer revaluation reserve to general fund on disposal							£1k			£1k						
Net Operating Costs transferred to General Fund at year end						£21k			£21k	£4k					£4k	
	C/F 0		**C/F 0**		**C/F 0**			**C/F 0**		**C/F £25k**		**C/F £0k**		**C/F £25k**		**C/F £0k**

11. Capital Grants to Other Bodies

11.1 Capital grants are unrequited transfer payments to external bodies which the recipient must use for the purposes of procuring or improving fixed assets from which the Health Board's residents will benefit in terms of achieving its objectives.

11.2 Capital grants are a budgeting mechanism whereby such payments are charged against non-core RRL. This is achieved by deducting the revenue expenditure that is included in the SOCNE in the period in respect of these payments, from the charge against the RRL and adding it to the charge against non-core revenue in the respective resource outturn statements. It must have been accounted for as revenue expenditure in the period within the definitions of the NHS Scotland Annual Accounts Manual.

11.3 Health Boards must be able to demonstrate that the recipient body has agreed to use the capital grant funding for specific purposes that meet the definition of capital expenditure and contribute towards the achievement of the Board's objectives. Note that this should not confer any responsibility to determine nor confirm the accounting treatment of the recipient body, as this will be a matter for their own auditors. Nor should it require any verification of the value added to the recipient's balance sheet. However capital grants made to other health boards will need to be agreed to be treated as capital income by the recipient board.

11.4 Where a payment in respect of a property is considered to represent prepayment of lease rental then it should be accounted for appropriately and therefore no expenditure can be transferred as a capital grant to the charge against the CRL. Particular reference should therefore be made to the substance of complex transactions and the accounting treatment deemed most appropriate and the Board may wish to take accounting advice to develop considered robust proposals in respect of potential capital grants. The Board should then seek audit opinion on such proposals before proceeding well in advance of the year end.

12. Public Private Partnerships (PPP) / Private Finance Initiative (PFI) Contracts / NON PROFIT DISTRIBUTING (NPD) MODEL / HUB INITIATIVE CONTRACTS

12.1 Introduction

12.1.1 The objective of the PPP/PFI/NPD model/HUB is to harness the benefits of private sector management in delivering services and fixed assets to the public sector.

12.1.2 Where an NHS body has a contractual arrangement to receive goods or services from another party (the 'operator'), and in providing the services the operator has to use an asset, the NHS body needs to consider whether it should recognise that asset in its own accounts.

12.1.3 The IFRS accounting standards which should be considered for such contracts are:

- An application of the principles of IFRIC 12, Service Concessions in Chapter 6 of the Treasury I-FReM ('the Application')
- IFRIC 4, Determining whether an arrangement contains a lease
- IAS 17, Leases
- IAS 16, Property, Plant and Equipment.

12.1.4 In determining which standard to apply, it is necessary to consider the substance of the transaction.

12.1.5 Where the contract is clearly ***solely for the construction of an asset*** and no services are provided then IAS 16 should be applied (see chapters 3 to 6). This situation might happen where an NHS body pays for a large proportion or all of the cost of a new asset as or soon after it is completed.

12.1.6 Where the contract is clearly for the ***lease of an asset*** and no significant services during the lease term are included in fixed payments then it should be accounted for as either a finance lease or an operating lease, as appropriate, under IAS 17 (see chapter 8). This situation might happen where an NHS body pays rental for an asset and pays separately to operate and maintain the asset.

12.1.7 Where the contract involves ***solely the provision of services*** without the use of a dedicated asset over which the NHS body has sole control or use, then payments made under this arrangement should be accounted for as operating expenses. This situation might happen where the

payments vary directly with the level of services received or where any assets used to provide the services may also be used for other arrangements without restriction.

12.1.8 Where the contract involves the provision of assets and services, it should be considered in terms of whether it is in substance a service concession in accordance with the Application (see 12.4 below), and if not, whether it is an arrangement containing a lease under IFRIC 4.

12.1.9 The various transactions that comprise a PPP/PFI/NPD model/HUB project differ from 'routine' NHS accounting only by virtue of their novelty and complexity. IFRS applies equally to PPP/PFI/NPD model/HUB contracts and so the capital accounting guidance contained in this Manual applies equally to PPP/PFI/NPD model/HUB transactions. Further detailed accounting guidance is to be found in: http://www.info.doh.gov.uk/doh/finman.nsf/ insofar as it is applicable to NHS Scotland.

12.1.10 The specialised and complex nature of PPP/PFI/NPD model/HUB and similar arrangements is addressed in detail in guidance issued by HM Treasury and the Infrastructure Investment Unit (IIU) in the Scottish Government. General enquiries should be addressed in the first instance to the IIU or via their web site http://www.scotland.gov.uk/Topics/Government/Finance/18232 which includes links to the Treasury Taskforce and other PFI related web sites. The purpose of this Chapter is to highlight the key accounting issues arising from PFI and outline their accounting treatment.

12.1.11 Given the complex nature of PPP/PFI/NPD model/HUB projects, NHS bodies entering into such projects should consult fully with the SGHSCD over the funding issues and technical accounting requirements.

12.1.12 The nature and extent of PPP/PFI/NPD model/HUB and similar contracts and the associated risk inherent in all major contracts/transactions, is likely to direct the external auditor's planning towards coverage of the area in the NHS body.

12.1.13 This work may cover issues such as Value-for-money, affordability, management arrangements and balance sheet treatment. Early engagement of auditors in the process will assist NHS bodies in identifying any audit issues and allow time for these to be reviewed/resolved.

12.2 Service Concession or Lease

12.2.1 In practice wherever contracts involve the provision of assets and services to an NHS body it should in the first instance consider whether it is in substance a service concession, and if not, whether it is an arrangement containing a lease. In the latter case, IAS 17 covers lease accounting and details the categorisation of leases into 'finance' or

'operating'. Chapter 8 of this Manual discusses lease accounting. In the PPP/PFI/NPD model/HUB context, however, lease or lease-type transactions will often be part of a wider inter-related series of transactions and so it will not always be possible to apply IAS 17 in isolation to individual transactions. Rather, the substance of the transactions as a whole should be considered under the Application to determine whether the arrangement is a service concession or a lease.

12.2.2 Where the elements of service concessions within the meaning of the Application are separable between the service elements and the property elements, IAS 17 principles are then applied to the latter.

12.3 Service Concession Agreements – Key Questions

12.3.1 In order for a PPP/PFI/NPD model/HUB contract to fall within the scope of the Application, the answer to all of the following questions must be 'yes':

- Is the contract, in substance, a service concession?
- Is an 'infrastructure' asset used to provide the services?
- Can the NHS body control or regulate:
  a) The services provided using the asset?
  b) To whom the services are provided?
  c) The price charged for the services?
- Does the NHS body control the residual interest in the asset at the end of the concession?

12.3.2 In practice, for most PPP/PF/NPD models, the answers to all of these questions is likely to be 'yes'. In respect of the HUB initiative, the projects are likely to be a much wider range of service and facility procurement options, but some may be service concession agreements. Any arrangement falling under the scope of the Application will require the grantor to recognise the property underlying the arrangement as a fixed asset; hence the transaction will be on balance sheet.

12.3.3 The guidance below provides further guidance on these criteria.

12.4 The substance of a service concession

12.4.1 For a contract to fall within the scope of the Application, there are features which it must possess, the first two of which are that:

- the private sector provider provides services to the NHS body and/or services to other parties on behalf of the NHS body; and

- the contract involves the use of an asset that is dedicated to the arrangement in providing those services.

12.4.2 These two features seek to identify whether the contract is, in substance, a service concession i.e. the provision of services involving the use of an asset. The services are usually restricted to managing and operating the asset but may also include provision of the public service required under the arrangement.

12.4.3 The Application does not define a service concession, but instead describes the typical characteristics. It notes that a service concession: "typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining it for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes".

12.4.4 The Application goes on to say that service concessions often include the following features:

- The procuring entity is normally a public sector body, or in some cases is an entity to which the responsibility for the function has been devolved.

- The operator is responsible for managing at least some of the assets and services i.e. it is not acting merely as an agent.

- The contract sets the initial price and the mechanism through which future prices are to be set or regulated.

- The operator is obliged to transfer the asset to the public sector body at the end of the contract, in a specified condition for little or no additional consideration. Practitioners should note that some arrangements give the grantor an exclusive right to purchase the asset at the end of the contract period for an amount that may equal or depend on the asset's open market value as at that time.

Not all of these features need be present in a service concession. However, as a minimum, the arrangement should require the provision of services with a dedicated asset, or management of the asset for a fixed period of time.

12.5 Infrastructure assets

12.5.1 IFRIC 12 covers 'infrastructure' assets for public services. A definition is not provided in the IFRIC, but it does instead provide a list of the types of assets which have traditionally been constructed, operated and used by the public sector and therefore are considered to be within scope of the

IFRIC: "..roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks…."

12.5.2 It can therefore be seen that hospitals are clearly within the scope of the standard. In practical terms for NHS bodies 'hospitals' would include any type of asset used to provide healthcare.

12.5.3 The IFRIC notes that a feature of service concessions is the public service nature of the obligation, whereby the infrastructure asset is used to provide services to the public – either by the operator or by the public sector body. This is generally interpreted to mean that in order for an asset to qualify as 'infrastructure' the public must somehow ordinarily have access to it. In most cases, hospitals will be accessible to the public and therefore would meet this requirement.

12.5.4 However, the Application extends the scope of infrastructure assets to include also:

- permanent installations for military etc. operations; and
- non-current assets used for administrative purposes in delivering services to the public.

12.5.5 Of these two additional categories, 'non-current assets used for administrative purposes in delivering services to the public" is likely to be most relevant to NHS bodies. Effectively it means that virtually all PPP/PFI/NPD model assets and some HUB assets used to provide services to the NHS body may fall within the scope of 'service concessions', including, for example:

- administrative buildings procured under a PPP/PFI/NPD model/HUB; and
- PPP/PFI IT assets used by the NHS body.

12.5.6 The scope of 'infrastructure' assets under the Application is therefore wide and most PPP/PFI/NPD model assets and some HUB assets are likely to fall within it.

12.6 Control or regulation of the services during the concession

12.6.1 The relevant test is set out in paragraph 5 (a) of IFRIC 12, as follows: "the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price;"

12.6.2 As can be seen from the wording in the test, there are three elements. The overall test will be met only where all three of these elements are present in the service concession.

12.6.3 ***Regulating the services which the operator must provide.*** In most PPP/PFI schemes/NPD model and some HUB schemes, the assets to be used are clearly identified in the contract. The contract will also specify the services to be provided to the NHS body. Where the assets are not specified in the service concession, the NHS body will need to consider the substance of the arrangement and whether in practice the service provider is using dedicated assets to provide the services being received. Practitioners should note that where the operator has discretion in how it manages and services the asset, this does not mean that the operator controls the services.

12.6.4 ***Regulating to whom the services must be provided***. Where the NHS body can control or regulate to whom the services are provided, then this element will be met. In most cases, such control or regulation will be achieved through the contract. For PPP/PFI/NPD model and certain HUB projects, the contract taken as a whole will normally provide such control by requiring the asset to be built on an agreed site (which may also be specified by the NHS body, e.g. an existing NHS site) and to be available i.e. open for access by patients, staff and others during set times.

12.6.5 ***Controlling or regulating the price.*** The price in this context refers both to the amounts that the NHS body pays to the operator, and the ability the operator has to charge users of the asset for the services provided. In most PPP/PFI/NPD model and certain HUB transactions the contract contains a mechanism for determining the price, which may be a pre-agreed mechanism for adjusting the price in future years, for example to take account of inflation. This mechanism is sufficient to represent 'control' for the purposes of this test. The presence of an agreed formula, for example to increase the unitary payment by the movement in RPI, prevents the operator from charging a different price in the event that its cost base suffers an unpredictable change such as cost increases above RPI or additional unplanned lifecycle replacement costs. The use of a payment formula in the contract is sufficient, therefore, to give the NHS body control over the price for the purposes of the IFRIC. In addition, if the operator is not allowed to charge users to access the services (e.g. to charge patients to visit the hospital), this would constitute control for the purposes of this test. Finally, some arrangements may allow the operator to charge users (for example residences or car parking). If these charges may only be varied according to an agreed mechanism, this would also constitute control for the purposes of this test.

12.7 Control of any significant residual interest in the asset at the end of the concession

12.7.1 The test is set out in paragraph 5 (b) of IFRIC 12, as follows: "the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement."

12.7.2 IFRIC 12 states that the residual interest of the asset is the "estimated current value of the infrastructure as if it were already of the age and in the condition expected at the end of the period of the arrangement." The term 'significant' is a matter of judgement, but in most cases it should be fairly clear whether the assets have a significant residual value (see 12.8.1 (b) below)".

12.7.3 Where a service concession involves a specialised asset, the operator will normally have little use for it at the end of the concession because there are few, if any, other parties who may wish to acquire it (unless it can readily be converted to an alternative use for minimal cost). Consequently, the financial arrangements in the concession will normally involve the operator recovering the cost of the asset, together with the financing costs, from the price charged over the life of the contract.

12.7.4 In such circumstances, the NHS body will have paid for the asset over the life of the scheme. Consequently, the contract will normally include a clause whereby the NHS body acquires the asset automatically at the end of the scheme for either a nil or a token payment. In some cases, this may take the form of an option for the NHS body to acquire the asset for a token payment. In all of these cases, the NHS body is considered to have control over the residual interest in the asset and therefore this test will be met.

12.7.5 Where the NHS body has an option to purchase the asset at the end of the scheme which the operator cannot refuse, the NHS body will still control the residual interest because as stated in paragraph AG4 of IFRIC 12, the operator's ability to sell or pledge the asset is restricted.

12.8 Concluding whether the arrangement should be assessed under the Application

12.8.1 Having considered the nature of the scheme and whether the NHS body has control of the asset in accordance with the tests within the Application, the asset will fall within the scope of the Application where:

- The scheme is a service concession involving the provision of services and a underlying infrastructure assets by the operator; and
- The NHS body controls the services which are provided using the asset; to whom they are provided; and the price charged; and
- Either:
  a) The NHS body controls the significant residual interest in the asset; or
  b) The asset will have no significant residual value at the end of the concession.

12.8.2 Where the service concession falls under the Application, the NHS body will have to recognise any related asset and an obligation to pay for it in its balance sheet appropriately.

12.8.3 As described earlier, when concluding which accounting standard applies, NHS bodies should consider the substance of the transaction. The transaction falls under the Application if is a service concession. However, where the arrangement is clearly different in substance e.g. a Landlord-repairing lease, then another standard (in this case IAS 17) should be applied.

12.9 On Balance Sheet: Purchaser (NHS body) has an asset of the property

12.9.1 Where the scheme falls within the scope of the Application, the Application requires the NHS body to recognise the infrastructure asset together with a corresponding liability to pay for it on its balance sheet. It requires application of specific accounting standards for recognition and measurement of the transaction, as described below.

12.9.2 **Recognising the asset**. The grantor should recognise the infrastructure as a non-current asset and value it in the same way as other non-current assets of that generic type. The asset will be recognised when:

a) it is probable that future economic benefits associated with the asset will flow to the organisation; and
b) the cost of the asset can be measured reliably.

12.9.3 The grantor should consider the asset recognition criteria together with the specific terms and conditions of the binding agreement, when determining whether to recognise the service concession asset during the period in which the asset is constructed or developed. If the asset recognition criteria have been met a work-in-progress service concession asset and associated liability should be recognised.

12.9.4 For NPD and hub DBFM projects, these asset recognition criteria will normally have been met once the project has entered construction. It will usually be appropriate to estimate the value of the asset under construction using the forecast cost profile from the financial close model.

12.9.5 The asset is initially recognised and measured at its fair value in accordance with IAS 17 'Leases' and is subsequently measured at fair value in accordance with IAS 16 'Property, Plant and Equipment' (PPE), in the same way as other PPE assets of the NHS body. On completion, the asset should be transferred from Assets under Construction to the appropriate asset category, again in the same way as other PPE assets. Chapters 3 to 6 provides further guidance on accounting for PPE assets.

12.9.6 **Recognising the liability.** A liability is initially recognised for the same amount as the fair value of the asset (less any NHS payments such as

capital contributions or prepayments). This liability is subsequently measured as a finance lease in accordance with IAS 17 Leases and, as such, revaluations of the asset following the initial recognition at cost do not affect the carrying value of the liability. This is addressed in chapter 8.

12.10 Identifying the elements of the unitary charge

12.10.1 The annual unitary payment needs to be allocated between a number of elements:

- payment for services – this reflects the fair value of the services received each year under the concession;
- payment for the property – this represents the annual lease rental for the asset which includes a repayment of the finance lease liability, an annual finance charge on the outstanding liability, and contingent rental; and
- lifecycle replacement – service concessions typically require the operator to maintain the asset in the required condition throughout the life of the contract. This usually requires the operator to replace individual capital assets during the contract. To the extent that this is predicted beforehand, the operator factors the cost of this into the unitary payment, and therefore an element of the unitary payment represents payment for future capital expenditure.

12.10.2 The above principles are relatively simple in concept. However, the complexity of PPP/PFI/NPD model and certain HUB schemes and similar schemes and the variations between schemes mean that applying them in practice can be difficult. It is recommended that NHS Bodies refer to the Department of Health Guidance on PFI under IFRS for specific guidance.

12.10.3 Generally, the NHS body should recognise each property when it is first made available to the NHS body. In schemes with a phased implementation, i.e. where some assets are made available at one point in time and others are made available later, then the NHS body should reflect this in its recognition of the assets in its accounts.

12.10.4 The following table sets out the accounting transactions for an on balance sheet PPP/PFI/NPD model/HUB project.

Initial Amount

Dr PPE Cr Finance lease liability	Capitalisation of lease at Fair Value.

Subsequent Transactions

Asset	Property, plant and equipment – subject to indexation or valuation and depreciated over useful economic life
Liabilities	Finance lease payable subsequently reduced by capital element of payment for the property
Operating Cost Statement	Depreciation charge to Operating Cost Statement Total rental payment less capital repayment element = charge to Operating Cost Statement (interest and contingent rent elements) Service element of finance lease

12.11 Lifecycle replacement costs

12.11.1 There is no specific accounting treatment prescribed for PPP/PFI/NPD model and HUB lifecycle costs within IFRS or other government accounting guidance. However lifecycle cost that relate to the improvement or replacement of an existing asset should be capitalised where the value of the improvement or replacement and the existing assets can be measured reliably.

12.11.2 NHS bodies should consider the points set out in summary below and recognise the resultant expenditure as they deem appropriate:

- For each year of the contract, an element of the unitary payment is allocated to lifecycle replacement based on the costs that the operator expects to incur for each year.

- Subsequently in each year, the actual capital cost is incurred by the operator and recognised as an addition to the relevant assets to the extent that the NHS body is able to identify the expenditure incurred and the assets to which it is related.

- To the extent that the capital cost is not reflected in the agreed life cycle costs it is ultimately borne by the operator because the expenditure or the cost of the asset is greater than the charges payable. The NHS Board would therefore receive value in excess of the lifecycle costs charged by the operator.

- Where the operator replaces lifecycle components earlier or later than planned but the cost of the replacement was anticipated in the operator's model, the NHS body receives value in advance or in arrears of the lifecycle payments made.

- The lifecycle costs element of the unitary payment is likely to be based on a model developed by the operator to anticipate likely costs to be incurred in maintaining the asset to the standard specified. This will probably include an element in respect of the risks assessed by the operator for which they will charge a premium.

- Where it is not possible to identify expenditure on improvements or replacements or identify the related assets and the effect of not capitalising related life cycle costs can be demonstrated to make sufficiently little difference to expenditure NHS Boards may apply suitable estimates in determining how to account for them appropriately.

12.12 Off Balance Sheet: Operator (PPP/PFI/NPD model/HUB Partner) has an asset of the property

12.12.1 While it is expected that very few PFI projects will be off balance sheet for the grantor, this might occur if the arrangement is outside the scope of the Application as summarised in paragraph 12.8.1 above. If this

situation arises, the transaction is considered under IFRIC 4 to determine whether it contains an "embedded" lease.

12.12.2 If there is no embedded lease, all payments made to the operator are recorded in the Operating cost statement as incurred.

12.12.3 If there is an embedded lease, it is considered under IAS 17 and the payments made to the operator are expensed as incurred if the lease is an operating lease.

12.12.4 If the lease is a finance lease, the arrangement is on balance sheet for the grantor and accounted for in a similar manner to that set out above for service concessions falling under the Application.

12.13 Contributions of existing assets

12.13.1 Contributions to a PPP/PFI/NPD model/HUB contract by the NHS body may take a number of forms, including an upfront cash payment or the contribution of existing assets for development by the operator. The accounting treatment of such contributions depends on the nature of the asset and whether they give rise to future benefits for the purchaser. For example:

- Where land is contributed for subsequent use within the PFI/NPD model/HUB project, it should continue to be recognised as an item of PPE in the accounts of the NHS body. This reflects the fact that the NHS body continues to control the land asset in the same way that it would control the buildings asset under the Application. Where land is donated to the operator but not for use in the PFI project, the NHS body will derecognise the land for an amount equal to its fair value. This amount would be held as a prepayment until the PFI/NPD model/HUB project assets are recognised, at which time the opening value of the finance lease liability is debited with the value of this prepayment. This treatment is therefore the same as a cash contribution as discussed below.

- Where other assets (e.g. buildings, equipment) are contributed for subsequent use in the service concession, then their treatment in the Balance Sheet should follow that of the concession assets themselves. Where a scheme falls within the scope of the Application, the concession assets will be 'on-balance sheet' and therefore the contributed asset should remain as an item of PPE in the Balance Sheet of the NHS body.

- Where the NHS body has made an initial cash payment to the operator it should be accounted for as follows:

  (a) Until the concession asset is made available to the NHS body and recognised as an item of PPE, the cash payment should be treated as a prepayment of the finance lease liability in the Balance Sheet of the NHS body; and

(b) Once the asset is made available, and is recognised in the Balance Sheet together with the finance lease liability, the cash payment should be transferred from prepayments and debited against the finance lease liability. The cash payment therefore is treated as an initial payment against the finance lease liability.

- If the cash payment is demonstrated to be a prepayment for future services rather than mitigating the operator's financing requirement, then the cash prepayment should not be netted-off the lease liability. Rather, such payments should instead continue to be recognised as a prepayment and amortised to operating expenses in line with the benefit received. Only where the NHS body is able to reclaim potentially all of the cash payment in the event of non-performance by the operator would the cash payment be accounted for as a prepayment.

12.14 Disclosure requirements

12.14.1 The disclosure requirements for a lessee under a PPP/PFI/NPD model contract and certain HUB projects are set out in paragraph 32 of IAS 17. In addition, NHS bodies will be required to disclose the amounts recognised as finance lease payables and their in-year transactions within the financial instruments disclosures in their annual accounts under IFRS 7.

12.14.2 Since the annual payments under PPP/PFI/NPD model contracts and certain HUB projects contracts are likely to vary from year to year, beyond an adjustment due to indexation, the payments in later years might differ from those which the purchaser is committed to make during the next year. If the estimated annual payments in future years are expected to be materially different from those which the purchaser is committed to make during the next year, the likely financial effect also needs to be disclosed in the financial statements.

12.14.3 The following information is also required for those schemes assessed as off balance sheet:

- description of scheme;
- estimated capital value;
- contract start and end dates;
- prepayments; and
- reversionary interests.

12.14.4 Even where the transaction does not result in any items being recognised in the balance sheet, the transaction may give rise to guarantees, commitments or other rights and obligations which, although not sufficient to require recognition of an asset or liability, require disclosure in order that the financial statements give a true and fair view.

12.14.5 There may also be potential contingent liabilities or provisions to account for where pre-works agreements are in place and these expose the public sector to potential costs incurred by the contractor up to acceptance of the main agreement.

12.15 Funding - Reversionary Interest

12.15.1 The standard PPP/PFI/NPD/Hub contracts involving construction of premises specify that at the end of the contract the premises becomes the property of the NHS. The accounting for the reversionary interest differs under UKGAAP/ESA95 and IFRS as follows:

- UKGAAP/ESA05: Where the asset is off balance sheet, an annual charge against CRL is made so that by the end of the contract the total reversionary interest in the asset is capitalised.
- IFRS: The asset is capitalised at inception, so the annual charge for reversionary interest against CRL is not relevant.

The difference in accounting between UKGAAP/ESA95 and IFRS is dealt with through the mechanism of a budget adjustment, where notional CRL cover is provided for the asset capitalised under IFRS. As part of this arrangement the annual reversionary interest was previously clawed back through deduction from the Board's CRL. The following revised arrangements are now in place:

- For contracts that reached financial close prior to 1 April 2009, the funding of the reversionary interest through deduction of the annual reversionary amount from CRL allocation will continue.

- For contracts that reached or will reach financial close from 1 April 2009 onwards, the funding of the reversionary interest is dealt with centrally and no deduction is made from a Board's CRL in this respect.

12.16 Refinancing

12.16.1 Following the Code of Conduct for the Refinancing of PPP/PFI/NPD model/HUB transactions there may be a need to account for changes to the original financing element of PPP/PFI/NPD model/HUB assets. This is because the NHS body will be entitled to a share in the benefit accruing to the operator ('Refinancing Gain') due directly to the refinancing.

12.16. 2 The NHS body may either take the Refinancing Gain as an up front cash payment or as a reduction in unitary charge. Depending on which of these options the NHS body chooses, the refinancing may result in changes to the remaining rental payments or may take the form of additional funding flows, either at the start of the revised contract or at other periods over the remaining period of it.

12.16.3 ***Reduction in the annual unitary payment***. The substance of the reduction is a lower cost of project capital and therefore NHS bodies should account for the reduction by recalculating the implicit interest rate in the lease, and then applying this lower interest rate prospectively over the remaining life of the lease. This will result in different amounts being charged to the Operating Cost Statement each year for finance lease interest and contingent rentals from those arising from the original contract from the time at which the refinancing takes place. These differences will therefore form part of the amount to be charged to the NHS body's RRL and will thus inform the financial impact of the refinancing deal.

12.16.4 The difference between the expenditure charged to the Operating Cost Statement under the original contract and that following refinancing will determine the financial impact of the refinancing. From the NHS body's point of view the timing of the cash flows of refinancing will be irrelevant in reaching a decision on whether to take the Refinancing Gain as a cash payment or a reduction in unitary charge. This is because the NHS body will be judged on the expenditure against the RRL and will be funded for its resultant cash requirement.

12.16.5 ***Cash lump sum received***. Any part of the refinancing gain that is received as a cash lump sum will be accounted for according to whether it is paid to the NHS body and any conditions attached.

(a) Where a cash lump sum is seen as conditional on the NHS body continuing the contract, the NHS body should recognise the refinancing gain as deferred income. This deferred income is then released to the Operating cost statement as finance income over the remaining life of the contract. The release of deferred income should reflect the extent to which the NHS body does not have to repay the sum.

(b) An unconditional cash lump sum will be received only on rare occasions. However, should this occur, the NHS body should recognise it as an immediate gain within the Operating Cost Statement.

12.17 PPP/PFI/NPD model/HUB

12.17.1 NHS Bodies should agree the application of PPP/PFI/NPD model/HUB accounting arrangements with the SGHSCD and their auditors.

12.18 HUB Initiative

12.18.1 The HUB initiative requires the public sector partners to take a 30% shareholding in the HUB company that is formed to procure facilities. The funding for the shareholding is provided to the lead Board by SGHSCD through a CRL allocation. Boards should account for this

investment as a non-current financial asset and should describe the investment and the basis of valuation.

12.18.2 During the establishment of the HUB company certain costs are incurred by the lead Board in respect of initial set up, e.g. Programme Director and support staff salaries, legal and professional fees, etc. These costs should be expensed in the Operating Cost Statement.

12.18.3 The lead Board also receives seed funding through CRL for the HUB company working capital. This should be accounted for as a loan, with an expectation that this amount will be repaid in future financial years.

12.18.4 **Accounting/Classification and Budgetary Treatment of Design, Build Finance and Maintain (DBFM) Projects**

Hub Co will undertake build projects in Primary and Community Care. The procurement routes can be via normal design and build using CRL, but a further option is Design, Build Finance and Maintain (DBFM) where the NHS Board pays the private sector partner under the Non Profit Distributing Model for the services provided, i.e. a Unitary Change is paid for the use of a facility and services provided.

All DBFM schemes need to be considered for both:

1. The accounting implications of the scheme for the procuring authority; and

2. The budgetary implications for the NHS Board and Scottish Government.

Depending on the specific details of each NHS DBFM project, there may be different budgetary treatments with regard to how the NHS Board deals with the Unitary Charge payments in its accounts.

(a) Accounting Implications

The UK now follows the International Financial Reporting Standards (IFRS) rather than UK Generally Accepted Accounting Practice (UK GAAP) which was previously the case. UK GAAP had a risk based approach to the classification of projects as on or off balance sheet. On the basis that a DBFM project could demonstrate that the majority of the project's risk was held by the private sector provider the project was classified as off the public sector's balance sheet.

However, under IFRS, which has a control based approach to asset classification, as the asset will be controlled by the NHS it will almost inevitably be regarded as on the public sector's balance sheet[1];

[1]There needs to be a clear distinction between budgetary treatment and accounting. In an accounting sense these projects will be on balance sheet but in accordance with HMT guidance if they are service concessions under IFRIC12 and pass ESA95 test they are budgeted for as off balance sheet

(b) Budgetary Implications

Scottish Government (SG) budgets are classified as either for revenue purposes or for capital purposes. The capital budgets have decreased substantially and the SG have introduced the revenue funded projects as a mechanism to take forward projects where there is insufficient capital cover. All DBFM projects, as revenue funded projects therefore need to meet the requirements of revenue funding. This is a condition of SG revenue support.

From a budgeting perspective, HM Treasury rules state that where a DBFM project is:

i. assessed as a service concession under the terms of IFRIC12; and

ii. satisfies the test outlined below for risk transfer under ESA95,

it will be classified as revenue and an adjustment will be made to the capital and revenue budgets to reflect the impact of the difference between treatment under IFRS and UK GAAP. In terms of HM Treasury spending controls the Unitary Charge will score against the revenue budget.

For an asset to be classified as a non-government asset under ESA95, two of the following three risks have to have been transferred to the private sector provider:

- Construction Risk;
- Availability Risk; and/or
- Demand Risk.

If the DBFM project is classified as a "non-government asset" under HM Treasury budget rules this is the best position for the NHS Board. If after applying HM Treasury budget guidance they are classified as a "government asset" the NHS Board will have to:

- allocate the capital budget available in respect of the facility; and
- pay for the Unitary Charge from their revenue budget (note that this does not mean that the NHS is physically paying for the asset twice, more that it scores against both capital and revenue budgets)

It is a condition of the Scottish Government Revenue Support package that the projects are classified as "non-government".

Therefore, it is important that an NHS Board reviews each project undertaken within the hub initiative and satisfies itself of the

appropriate accounting treatment in order to assess its financial impact. The standard hub DBFM contract has been designed to meet the risk transfer requirements of ESA95 for construction and availability risk. This should be backed up with appropriate professional advice where considered necessary and confirmation from auditors that they are content with the accounting treatment proposed.

12.18.5 Design Fee Guidance on Hub Projects

The initial projects within the Hub Programme have highlighted a particular cash flow issue for design teams providing services during the development of the projects. Hub agreements originally required supply chain entities to be paid only at Financial Close, which caused financial challenges for the design members of the supply chain due to the potential length of time between the work performed and payment thereof.

Revised guidance was issued on 15 May 2014, which implemented solutions for capital funded and revenue funded hub projects. (http://www.scottishfuturestrust.org.uk/publications/hub)

Capital Funded Projects

For capital funded projects Health Boards should utilise existing capital funding to pay for design fees during the development phase. Health Boards therefore are required to manage the expenditure from their CRL within the financial year.

Revenue Funded Projects (DBFM)

For DBFM projects Health Boards should first agree the apportionment of the cost of design fees with other partners. The Health Board should then request from SGHSCD the cost as a loan to hubco through additional CRL, being the equivalent to the Stage 1 and interim Stage 2 design fees up to completion of Stage E design at a maximum of 80% of the total fee. The loan is repayable to the Health Board on Financial Close with funding from the drawdown of senior debt. On repayment of the loan the amount will be deducted from CRL. The following conditions apply to the loan:

- Repayable in full at Financial Close
- Date of Financial Close and repayment agreed with SGHSCD at issuance of the loan. The net financial risk of any delay beyond the agreed repayment date is for the Health Board to manage from CRL.
- Prior to implementing the guidance the Health Board should seek confirmation from SGHSCD regarding the overall revenue funding support for the project.
- The loan should cover the design fee costs equivalent to Stage 1 and up to a maximum of 80% of interim Stage 2.

The terms of the loan to hubco should be set out in a loan agreement signed by hubco and the Health Board. SFT are to develop a standard loan agreement, which is recommended to be used.

For further guidance Health Boards should contact SFT or their respective Territory Programme Director.

Accounting for the loan to hubco

On signing of the loan agreement and payment to hubco

Dr Loan to hubco
Cr Cash

The loan to hubco will be accounted for as a financial asset and will be covered by additional CRL from SGHSCD. Hubco will use the loan to pay design fees.

Settlement of loan receivable from hubco on receipt of drawdown of senior debt at Financial Close

Dr Cash
Cr Loan to hubco

Settlement of the loan to hubco will be reflected in an equivalent reduction in CRL.

Recognition of the IFRS fixed asset arising from DBFM projects is set out above in section 12.18.4.

13. Asset Registers

13.1 Introduction

13.1.1 Each NHS body must maintain an asset register. Asset registers support the annual accounts and so are subject to audit by an auditor appointed by Audit Scotland. The benefits arising from keeping a comprehensive asset register are:

(1) improved physical asset accountability and risk management;

(2) access for managers to an information system covering all their assets;

(3) the provision of a firm baseline for improved asset management;

(4) the capacity for a planned asset maintenance, repair and replacement programme;

(5) to assist in the calculation of capital charges;

(6) to assist in the preparation of NHS bodies Capital Charge Forecast and Property Transaction Returns.

(7) the ability to make comparisons between NHS bodies.

13.1.2 The asset register may also be used to ensure proper management and control over assets that cost less than the capitalisation threshold or those held under operating leases. If this is done, the asset register must be so designed to ensure that capital assets are distinguishable from non-capital assets.

13.2 Minimum data set

13.2.1 The minimum data set to be used for individual assets to establish and maintain an asset register for capital accounting purposes is as follows:

(1) Asset identification and description

(2) Asset location

(3) Date of acquisition

(4) Method of acquisition (source of funds)

(5) Initial capital expenditure (purchase price)

(6) Current gross fair value (valuation or indexation)

(7) Depreciated Historic Cost

(8) Current Cumulative depreciation/amortisation charged to the end of the previous financial year (including buildings since date of acquisition or revaluation)

(9) Depreciation/amortisation charged in year

(10) Indexation adjustments (both on replacement cost and on accumulated depreciation)

(11) Revaluation adjustments (following full revaluations)

(12) Capitalised subsequent expenditure

(13) Impairments (losses and reversals although these do not need to be separately recorded)

(14) Assessed life

(15) Assessed residual value

(166) Asset classification

(177) Asset status (i.e. whether in operational use, or in construction or declared surplus)

13.2.2 This is a ***minimum*** data set for accounting purposes, and should permit the analysis of the revaluation reserve asset by asset and donated asset reserve asset by asset. Additional data will be required for asset management purposes. This may include the provision of serial numbers or other unique identifier for equipment assets.

13.2.3 Data recorded in the minimum data set should allow a NHS body to produce reports that detail the revaluation reserve attached to individual assets, and show a value for historic cost depreciation that can be compared with current depreciation to calculate the revaluation reserve to General Fund annual transfer.

13.3 Scope of asset registers

13.3.1 All capital assets must be itemised on the asset register, including donated assets, assets held under finance leases, grouped assets, and fully depreciated assets. The initial equipping and setting-up costs of a new building must be included where these are capitalised.

The asset register must clearly distinguish between:

(1) purchased capital assets;
(2) leased capital assets;

(3) donated assets on which no cost of capital is charged;

(4) non-capital assets;

(5) grouped assets (as per limited examples allowable under the manual)

The asset register must be structured in such a way as to itemise:

(1) land separately from the buildings upon the land;

(2) land separately from the dwellings upon the land;

(3) separate buildings on the same site and their indivdual component parts.

13.3.2 The asset register should itemise the different asset ***components*** in accordance with the categories used by the appointed valuer and the guidance in chapter 5.5. For these individual assets the register may allow the various elements to be linked together.

133.3.3 The asset register should also be designed so as to allow the allocation or apportionment of capital charges to the appropriate cost centre.

13.4 Tagging

13.4.1 Asset registers should contain information to facilitate the locating and identification of assets, and in this respect, NHS bodies may utilise some form of asset tagging. Tagging refers to the physical labelling of individual assets and may be accomplished in a variety of ways ranging from simple adhesive manuscript labels to bar coding devices which are read by hand-held computer peripherals.

13.4.2 Although tagging is not essential for capital accounting purposes, or for the production of an asset register, it is strongly recommended. Managers will find it easier to maintain their asset registers and monitor equipment asset movements if these assets are easily identifiable. Where it is not possible to physically tag an equipment asset it is recommended that alternative record keeping arrangements are made.

13.4.3 NHS bodies should also periodically undertake a physical verification of assets to assure the accuracy of data held. This may be achieved on a rolling basis.

13.5 Security and integrity

13.5.1 NHS bodies should take appropriate steps to ensure the security and integrity of asset register systems is maintained. This will include the provision of password security, regular data backups, and the provision of an audit trail of amendments.

14. References

14.1 Publications

The following accounting standards and publications are referred to in this Manual. See http://www.ifrs.org/IFRSs/IFRS.htm for link for IFRSs listed below:

IAS 16, Property, Plant and Equipment	
IAS 17, Leases	
SIC 15, Operating Leases - Incentives	
SIC 27, Evaluating the Substance of Transactions Involving the Legal Form of a Lease;	
IFRIC 4, Determining whether an arrangement contains a lease	
IFRIC 12, Service Concession Arrangements	
IAS 20, Accounting for Government Grants	
SIC 10 Government Assistance – No Specific Relation to Operating Activities	
IAS 23, Borrowing Costs	
IAS 40, Investment Properties	
IAS 41, Agriculture	
IFRS 5, Non-current Assets Held for Sale and Discontinued Operations	
Financial Reporting Manual (FReM)	http://www.financial-reporting.gov.uk/manual.htm
NHS Annual Accounts Manuals	2011-12 Annual Accounts Manual to be issued to all Boards by end of February.
Royal Institute of Chartered Surveyors (RICS) – Appraisal and Valuation Manual	Royal Institute of Chartered Surveyors www.rics.org

Scottish Capital Investment Manual	Issued 1996. Available from HMSO Books.
Department of Health NHS Financial Accounting Manual.	http://www.dh.gov.uk/en/Publicationsandstatistics/Publications/PublicationsPolicyAndGuidance/DH_4093972

15. Glossary and Abbreviations

Glossary and abbreviations

AD	Accumulated Depreciation
ASB	Accounting Standards Board
AUC	Asset(s) under construction
BCIS	Building costs information service
CA	Carrying amount
CAM	Capital Accounting Manual
CRL	Capital Resource Limit
DRC	Depreciated Replacement Cost
EUV	Existing use value
FRAB	Financial Reporting Advisory Board
FRS	Financial Reporting Standard
FVLCTS	Fair value less costs to sell
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
IT	Information technology
MEA	Modern equivalent asset
NBV	Net book value
NPV	Net present value
NRV	Net realisable value
OCS	Operating Cost Statement
OMV	Open market value
OMVEU	OMV for existing use
PFI	Private finance initiative
PV	Present value
R&D	Research and development
RC	Replacement cost
RRL	Revenue Resource Limit
SCIM	Scottish Capital Investment Manual
SHOW	Scottish Health on the Web
SGHSCD	Scottish Government Health Directorates
SIC	Standing Interpretations Committee