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Directors of Finance:

NHS Boards
Special Health Boards
National Services Scotland
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Your ref:
Our ref: F1435344
18 April 2008

Dear Colleague

NHS Capital Accounting Manual 2007-08

Please find attached a revised version of the Capital Accounting Manual for 2007-08. This incorporates the changes to the accounting and funding treatment of impairments and profits and losses on disposal of fixed assets that have previously been highlighted to you. Further changes have also been incorporated to clarify guidance on the capitalisation of expenditure that I would bring to your attention.

The sections that have been changed are highlighted in the table below with details of the nature of the changes made.

Section	Issue
1.1.2	Clarify applicability of FreM and ASB guidance.
2.4	Change guidance on initial measurement and subsequent expenditure.
2.5 – 2.14	Move 2.14 to 2.5 and revise paragraph numbering
3.22	Change guidance on accounting for impairment
3.23	Change guidance on forecasting for impairment
3.24	Amend guidance on accelerated depreciation to be in line with treatment of impairments
3.25	Amend guidance on reversal of impairments to be in line with revised treatment
4.13.3	Change guidance on timing of recognition of accelerated depreciation
5.3.2-5	Change treatment of profits and losses on disposal of assets
5.3.7	Amend example 2
Appendix	Added case study to illustrate accounting assessment process

Please bring these proposed changes to the attention of those responsible for producing annual accounts for your health board. Should you wish to query any of these changes or request any further changes please advise me of them by 28 April 2008 when I will finalise the manual for 2007-08.

Yours sincerely



Lee Shedden
Head of Reporting & Control

CC: Jane Davidson, Joe Welsh, Robert Peterson, Julie McKinney, Mike Baxter – Health
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NHSScotland
Capital Accounting Manual
2007/08

April 2008

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1. Introduction

1.1 Purpose of the Manual

1.1.1 The NHS Scotland Capital Accounting Manual (CAM) replaced the CAAM (Capital Asset Accounting Manual) and was last updated in February 2005. 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.

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

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

1.1.3 The CAM concentrates on technical accounting issues rather than detailed internal procedures which will be covered by HDLs.

1.1.3 Previous versions of the manual provided the service with relevant guidance particularly with regard to capital charging. This has been expanded to reflect the changing capital environment particularly the introduction of Private Finance Initiatives (PFI), Public Private Partnership (PPP) transactions, the effect of the introduction of HM Treasury's Financial Reporting Manual and the latest HDLs.

1.2 The CAM 2007 Edition

1.2.1 This edition supersedes that issued in March 2007. The new edition incorporates:

- the effect of compliance with the introduction of the Financial Reporting Manual.

1.2.2 This Manual will be available on the SHOW website at <http://www.show.scot.nhs.uk/sehd/fpma/manuals.htm>. It can be viewed as an electronic document on this site, or downloaded in Word format for local printing and reproduction. It is not available as a hard copy document for the NHS in Scotland.

1.3 Queries and Contacts

1.3.1 For technical guidance and enquiries on specific NHS Capital Accounting issues contact –

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2. Capitalisation and Valuation of Fixed Assets

2.1 Introduction

2.1.1 FRS 15 'Tangible Fixed Assets' has been applicable to the NHS from the year 1999-2000. 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 current-cost basis of valuation which UK GAAP does not always comprehensively address;
- 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 6 deals specifically with leases.

2.2 General principles and definitions

2.2.1 Assets are defined in Financial Reporting Standard (FRS) 5 as 'rights or other access to future economic benefits controlled by an entity as a result of past transactions or events'.

2.2.2 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.

2.2.3 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 FRS 5 and Statement of Accounting Practice (SSAP) 21 are dealt with more fully in Chapter 5 of FReM.

2.3 Tangible fixed assets

2.3.1 FRS 15 *Tangible Fixed Assets* applies as adapted to accounting periods beginning on or after 1 April 1999. In accordance with FRS 15, a tangible fixed asset is an asset which has physical substance and is held for use in the production or supply of goods and services, for rental to others, or for administrative purposes on a continuing basis in the NHS body's activities.

- 2.3.2 A tangible fixed asset will therefore have an expected useful economic life in excess of one year when newly acquired.

2.4 Initial Measurement

2.4.1 "A tangible fixed asset should initially be measured at its cost. Costs, but only those costs, that are directly attributable to bringing the asset into working condition for its intended use should be included in its measurement."

Subject to *de minimis* limits, all expenditure on the acquisition or creation of fixed assets should be capitalised on an accruals basis.

Typically expenditure on fixed assets 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 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 costs
- Professional fees (such as legal, architects' and engineers' fees)

A practical test to determine if expenditure is "attributable" is to consider whether the nature of the planned scheme is essential to bring the asset in to a working condition. In most cases of "new build" this is straightforward and simple to assess. For schemes involving internal reconfiguration of accommodation or a significant upgrade to existing infrastructure, assessing the "attributable expenditure" can be more difficult. For example if an existing building is no longer required for its existing purpose and requires significant expenditure to reconfigure the internal accommodation in order that it can be used for its alternative purpose then clearly this would be attributable to the ongoing use of the asset. If however the internal reconfiguration was simply an aesthetic exercise to improve the overall accommodation standard then this may not be seen as essential to the ongoing use of the asset and therefore not allowable as capital expenditure. The Appendix provides an example of a typical NHS building scheme. This approach applied to large schemes will assist Health Bodies in determining the appropriate accounting treatment.

2.5 Subsequent expenditure

- 2.5.1 Subsequent expenditure to ensure that a tangible fixed asset maintains its previously assessed standard of performance should be charged to the operating cost statement as it is incurred.

This type of expenditure is often referred to as “repairs and maintenance” expenditure. Examples are the cost of servicing or the routine overhauling of plant and equipment and repainting a building structure. Without such expenditure the depreciation expense would be increased because the useful economic life or residual value of the asset would be reduced.

However, subsequent expenditure on a tangible fixed asset should be capitalised in three circumstances:

- where it provides an enhancement to the economic benefits of the asset in excess of the previously assessed standard of performance;
- where a component of the asset, having been treated separately for depreciation purposes and depreciated over its individual useful life, is replaced or restored;
- where the subsequent expenditure relates to a major inspection or overhaul of the asset which restores the economic benefits of the asset which have been consumed by the entity and have already been reflected in depreciation.

Subsequent expenditure on a tangible fixed asset is recognised as an addition to the asset to the extent that the expenditure improves the condition of the asset beyond its previously assessed standard of performance. Examples of subsequent expenditure that results in an enhancement of economic benefit include:

- Modification of an item of plant to extend its useful economic life or increase its capacity
- *Upgrading machine parts to achieve a substantial improvement in the quality of output*

The FRS gives an example of an aircraft that must be completely overhauled according to a set timetable, and without that overhaul it has no economic life at all, as it would not be permitted to fly. The expenditure incurred in the overhaul thus extends its life, and can be considered as re-setting the depreciation clock. Such major overhauls tend to be in the nature of re-building, so are analogous to the creation of a new asset. Paragraphs 38 and 39 of FRS 15 provide further examples.

A practical test to determine if “subsequent expenditure” can be capitalised is to consider the planned scheme against the above criteria ie. Does the asset improve the standard of performance against previously assessed level, is the asset a separately identifiable and depreciated component or is the expenditure essential to continue operating the asset eg. for health and

safety or reasons of accreditation. Appendix provides an example of a typical NHS building scheme. This approach applied to large schemes will assist Health Bodies in determining and the appropriate accounting treatment.

2.6 Capitalisation Threshold - de minimis limits

2.6.1 Previously Government Departments were allowed to set capitalisation thresholds for fixed assets to suit their own circumstances. The Scottish Executive 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 SGHD is required to consider whether there is a significant impact on expenditure control.

2.7 Grouped assets

2.7.1 Where there are large numbers of similar or functionally interdependent assets, which, if treated singly, would fall below the capitalisation threshold, they may be grouped for the purposes of determining whether they fall above or below the threshold. This may apply, for example, to IT equipment and office furniture. This concept was previously disallowed from 1st April 1993 with certain exceptions. However it is now permissible to follow the following guidance more closely. The examples in 2.6.2 and 2.6.5 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 FRS 15 definition of tangible fixed assets, 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. In these circumstances, health bodies have the option to capitalise such expenditure as a single 'equipping' asset with a useful economic life of up to 10 years. Where it is intended to exercise this option, health bodies should consult with the SGHD.

2.8 **Tangible fixed assets - Expenditure to be capitalised**

2.8.1 FRS 15 clarifies which costs can and cannot be capitalised on acquiring or constructing an asset. It says:

'A tangible fixed asset should initially be measured at its cost. Costs, but only those costs, that are directly attributable to bringing the asset into working condition for its intended use should be included in its measurement'.

2.8.2 The FRS then details costs that are, and are not, '*directly attributable*'.

2.9 **Attributable costs**

2.9.1 Attributable costs include internal costs and bought in services. Guidance on what costs should be capitalised is included in FRS 15. It states that 'costs, but only those costs, that are directly attributable to bringing the asset into working condition for its intended use, should be included in its measurement'.

2.9.2 Costs incurred in the early stages of a project to acquire or create a tangible fixed asset (see 2.3) or an intangible asset other than development costs (see 2.19) should only be capitalised if at the time they are incurred:

- there is a clearly defined project;
- the costs are separately identifiable;
- it is reasonably certain that the project will be completed and will result in an asset that will eventually be brought into use.

- 2.9.3 The more detailed criteria for the capitalisation of development expenditure are described in 2.20; the general conditions for recognition of other intangible assets are described in 2.21 – 2.22.
- 2.9.4 Where an entity's own staff are involved in the acquisition, construction or development of a tangible fixed asset (such as a piece of internally generated computer software), 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.
- 2.9.5 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.
- 2.9.6 Internal costs should not be capitalised if they relate to activities which can only be carried out by in-house staff, i.e. which for the sake of good internal administration could not be purchased from an outside party.
- 2.9.7 FRS 15 allows, but does not require, entities to capitalise finance costs that are directly attributable to the construction of tangible fixed assets. However, to facilitate the preparation and consistency of whole of government accounts, departments and agencies are not permitted to capitalise cost of capital charges (see 5.2.6 of the FReM).

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:
- administration and other general overhead costs;
 - 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 a tangible fixed asset.
 - abnormal costs eg costs relating to:
 - design errors;
 - industrial disputes;
 - idle capacity;
 - wasted materials, labour or other resources; and
 - production delays.

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

2.11 Interest

2.11.1 The FReM specifically disallows the option of capitalising any finance costs (section 5.2.6) that are directly attributable to the construction of tangible fixed assets.

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 SGHD consultation (2.6.5) 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 taken 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 systems is occasionally raised. As the nature of the investment is in staff rather than fixed assets directly, such expenditure should always be treated as a revenue expense.

2.15 Equipment

2.15.1 Equipment is initially capitalised at its purchase price. Second-hand equipment however should be taken onto the balance sheet at its replacement cost (ie 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 4, Depreciation and Asset Lives).

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 6 (leases) deals with leases.

2.17 Donated assets

2.17.1 This is dealt with in chapter 8 and sections 5.2.12 to 5.2.15 of the FReM.

2.18 Assets transferred between NHS bodies

- 2.18.1 Once a Holding Body 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 Holding Bodies in its area. If such assets are to be transferred between NHS bodies the transfer should be accounted for as acquisitions and valued in accordance with FRS7 as per section 5.4.7 of the FReM. The accounting entries are detailed in section 5.4.4 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 Where transactions are between NHS bodies and third parties, NHS bodies are required to value assets scheduled for disposal at open market valuation for alternative use.

2.19 Government grants

- 2.19.1 The accounting treatment of government grants is covered by SSAP4. The objectives of SSAP4 are to ensure that government grants are recognised in the operating cost statement so as to match them with the expenditure towards which they are intended to contribute and are recognised only when the conditions for their receipt have been complied with and there is reasonable expectation that they will be received.
- 2.19.2 The following adaptations to SSAP4 apply:

Recognition

a) NHS bodies should credit grants received as a contribution towards the cost of a fixed asset to a government grant reserve (not to deferred income), which is then released to the operating cost statement over the useful economic life of the asset in amounts equal to the depreciation charge on the asset and any impairment – that is, the option given in SSAP4 to deduct the grant from the cost of the asset has been withdrawn.

Measurement

b) On disposal of an asset financed by government grant, the profit or loss is taken to the operating cost statement and is offset by a transfer from the government grant reserve of the same proportion of the profit or loss that the amount of the grant bears to the original acquisition cost of the asset. The balance on the government grant reserve in respect of that asset should be transferred to the general fund, representing that same proportion of the proceeds.

- 2.19.3 As it is important for monitoring and control purposes, entities that receive a grant that is intended to finance both revenue and capital expenditure

should analyse the grant between its constituent parts. Also the notes to the financial statements should distinguish between grants from UK government entities and grants from the European Union.

- 2.19.4 Funding from the Scottish Government Health Directorates is equivalent to funding from Parliamentary Vote described in section 4.2 of the FReM and should not be considered as a government grant. National lottery funded assets would normally be considered a donated asset and not a government grant.

2.20 Intangible fixed assets – capitalisation

- 2.20.1 Intangible fixed assets bought separately should be capitalised at cost.

2.21 Development Expenditure

- 2.21.1 Development expenditure should be capitalised where there is a clearly defined project for which expenditure can be separately identified and which an entity expects to complete with the result that an asset will be brought into use or in the case of entities engaged in profit making activities, where the project is commercially viable. Internal costs, including the charge for the cost of capital, should not be capitalised if they relate to activities that can only be carried out by in-house staff.

2.22 Goodwill

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

2.23 Other Intangible Fixed Assets

- 2.23.1 Other intangible fixed assets should be accounted for in accordance with FRS 10, which should be referred to for full details (apart from impairment, which should follow the more developed proposals in FRS 11). The following paragraphs in 2.23.2 – 2.23.12 are a summary only.
- 2.23.2 Other intangible fixed assets are defined as 'non-financial assets that do not have physical substance but are identifiable and are controlled by the entity through custody or legal rights'.
- 2.23.3 An intangible asset which has been purchased separately from a business should, initially, be capitalised at its cost.
- 2.23.4 An intangible asset which has been developed internally should be recognised but only if it has a readily ascertainable market value. This means that the asset must belong to a homogenous population of assets which are equivalent in all material respects, and that an active market, evidenced by frequent transactions, exists for them.
- 2.23.6 It is not expected that intangible assets will arise in resource accounting from the acquisition of a subsidiary (*see also 5.4 of FReM*).
- 2.23.6 An intangible asset should be amortised over its expected useful life, unless this is considered to be indefinite. There is a rebuttable presumption that

the life will be twenty years or less. Where the life is longer than twenty years, the asset should be reviewed annually for impairment; to the extent that the carrying value of the asset exceeds its recoverable amount, the asset is impaired and should be written down. The determination of recoverable amount in a not-for-profit context is discussed in paragraphs 5.2.2 to 5.2.12 of the FReM. In making major changes to the method of amortisation or to asset lives, prior consultation with SGHD is required to consider whether there is a significant impact on expenditure control.

2.23.12 Except in the two cases in this paragraph, goodwill and other intangible assets governed by FRS 10 should not be revalued either to increase the carrying value above original cost or to reverse prior-period losses arising from impairment or amortisation. First, FRS 10 allows, but does not require, NHS bodies to revalue intangible assets where they have a readily ascertainable market value (as described in 2.23.4). However, to facilitate the preparation and consistency of whole of government accounts in those cases where an intangible asset (covered by FRS 10) has a readily ascertainable market value, it should be revalued to its market value. Further revaluations should be performed annually to ensure that the carrying value does not differ materially from the market value at the balance sheet date. Second, where an external event caused the recognition of an impairment loss in previous periods, and subsequent external events clearly and demonstrably reverse the effects of that event in a way which was not foreseen in the original impairment calculations, any resulting reversal of the impairment loss which increases the recoverable amount of the goodwill or intangible asset above its current carrying value should be recognised in the current period.

2.23.12 Where an intangible asset is revalued (see 2.23.12) the amortisation charge may be based on opening, closing, or average values provided that a consistent basis is used.

2.23.12 This section of the manual is not intended to apply to in-house-produced computer software, which, if accounted for as an asset, following the rules set out in 2.12, should be regarded as tangible. Licenses to use software developed by third parties, however, should be treated as intangible.

2.24 Deferred assets in PFI schemes

- 2.24.1 Some PFI transactions involve the transfer of NHS assets to private partners (by lease, sale or otherwise as part of the deal). Unless a NHS body has in substance disposed of the asset at undervalue or for no consideration, in which case a loss on disposal must be recorded in the Operating Cost Statement, it is to be expected that some benefit will accrue to the NHS Body in return. This implies that an asset of some kind must have been created in return for the exchange of the original NHS asset.
- 2.24.2 In many cases, the benefit thus accruing will be in the form of a reduction in rental payments from the level at which they would otherwise have been set. The net present value of the cost saving in the expenditure stream should be treated as a prepayment within debtors and written off to the Operating Cost Statement in line with the underlying lease.

2.24.3 For the purposes of this Manual however, it should be noted that these deferred assets are **not fixed assets**, and should be accounted for as prepayments within current assets.

2.25 Measurement and valuation

2.25.1 Tangible fixed assets should be valued at the lower of replacement cost and recoverable amount. Recoverable amount is defined as the higher of net realisable value and value in use (as defined in paragraph 2 of FRS 11). The replacement cost for different classes of assets is described in the following paragraphs. An impairment occurs where the recoverable amount falls below its carrying amount, i.e. the value shown on the balance sheet (see 5.2.31 – 35 of FReM). The whole valuation process can be expressed diagrammatically as described at Figure 2.1 below:

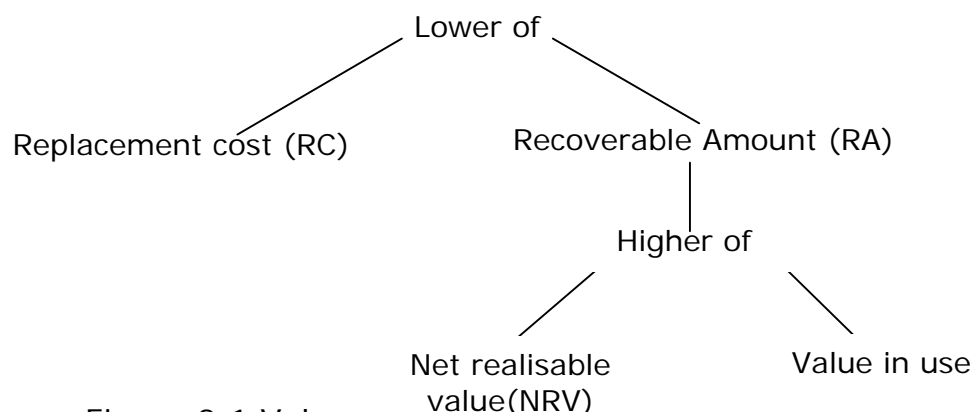


Figure 2.1 Val

2.25.2 The replacement cost for operational land and buildings is existing use value (as described in Appendix 1 of FRS 15), with the addition of notional directly attributable acquisition costs where material. In the case of specialised properties not normally traded on the open market, valuation on this basis may be inappropriate and/or impractical, and such property should be valued on the basis of depreciated replacement cost.

2.25.3 Properties surplus to requirements should be valued on the basis of open market values, less any directly attributable selling costs where material. This method of valuation overrides the valuation diagram in Figure 2.1, which is based on determining the value of the business of the asset and so is not directly applicable when the asset is surplus to requirements. Properties surplus to requirements should continue to be disclosed as fixed assets, but, if material, their existence and value should be disclosed separately in a note to the accounts.

2.25.4 Where a property or other fixed asset remains in use but is expected to become surplus shortly, the accounting treatment depends upon whether the expected disposal proceeds are anticipated to be less or more than current carrying value. Where the expected disposal proceeds are anticipated to exceed current carrying value, then the asset should be carried at its current value until the first balance sheet date after it becomes surplus, when it will be revalued to open market value in accordance with 2.24.3. The converse situation, where expected disposal proceeds are

anticipated to be less than current carrying value, is discussed in Section 4 of this manual.

- 2.25.5 Other (non-property) operational assets should be valued using open market value (as described in Appendix 1 of FRS 15), where possible. Where market value is not obtainable, these assets should be valued on the basis of depreciated replacement cost.
- 2.25.6 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.
- 2.25.7 Where an asset has been revalued, the depreciation charge is based on the revalued amount. This charge should ideally be based on average values, although it can be based on opening or closing asset values provided that a consistent basis is used. In the year in which an asset is acquired, a proportion of a full year's depreciation should be charged unless the difference between the proportional charge and the full year's charge is not material.
- 2.25.8 Land and buildings should be subject to professional valuation in accordance with paragraph 48 of FRS 15, and at intervals of not more than five years. This valuation should be adjusted in intervening years, if appropriate, to take account of movements in prices since the latest valuation. The professional valuation should be carried out in accordance with the *Appraisal and Valuation Manual* produced jointly by the Royal Institution of Chartered Surveyors (RICS), the Incorporated Society of Valuers and Auctioneers (ISVA) and the Institute of Revenues Rating and Valuation (IRRV).
- 2.25.9 Paragraph 44 of FRS 15 says that, for cost-benefit reasons, paragraphs 45–52 may not be appropriate for public sector bodies. This will be interpreted as not requiring the regular interim professional valuations in the third year of every five-year valuation cycle set out in paragraphs 45 (for properties) and 50 (for non-property assets where relevant) of FRS 15. NHS bodies should still have regard to paragraphs 45 and 50 in so far as those paragraphs require interim valuations where it is likely that there has been a material change in value of an asset (after taking account of indexation movements).
- 2.25.10 Revaluations of fixed assets other than impairments (see 3.11) should be credited or debited to a revaluation reserve, or to a donated asset reserve in respect of donated assets (see 5.2.14 of FReM), or to a government grant reserve in respect of assets financed from government grants (see 5.2.36 of FReM).

- 2.25.11 It is not necessary to disclose historical cost carrying amounts (where available) as required by paragraph 74 of FRS 15.
- 2.25.12 Specialised properties highlighted in section 2.24.2 are dealt with in FRS 15, which mentions hospitals and other specialised health care premises as examples of properties that may be considered specialised. Such properties should therefore be valued at Depreciated Replacement Cost (DRC).

2.26 Surplus assets

- 2.26.1 This is covered specifically in sections 2.24.3 and 2.24.4. The assumption is that assets which are not being used for operational NHS purposes at the date of valuation (ignoring temporary or de minimis use) would be valued at OMV for alternative use unless the health body could demonstrate that the property was being held for some prospective operational use covered by definite plans.
- 2.26.2 Assets which are still in operational use are dealt with in section 2.24.4. Where the asset remains in use until the disposal date, **accelerated depreciation** is applied if the expected disposal proceeds are anticipated to be less than the current carrying value. This should be applied to the whole of the asset to be disposed of, including any associated land, because it is not possible to split the market value between land and buildings. Assets temporarily out-of-use continue to be valued and depreciated as normal.
- 2.26.3 In most situations it will be relatively clear when an asset has been removed from operational use, as is the case for example, with a building prepared for demolition and declared surplus to requirements. In cases of doubt, only when the complete asset is capable of independent disposal should it be regarded as having been taken out of operational use. Partial closure, for example, during a run-down period will not be regarded as making an asset capable of independent disposal. However where elements of an existing site are to be disposed of separately these should be treated separately.
- 2.26.4 Properties that are surplus to requirements and not in use should not be depreciated, they shall however continue to incur a cost of capital.

2.27 Modern equivalent asset

- 2.27.1 The normal basis of valuation may not be appropriate if a modern substitute is markedly different in cost, or where technological advances have resulted in likely replacements having significantly improved quality or quantity of outputs. Under such circumstances, it is necessary to undertake a modern equivalent asset calculation to arrive at a satisfactory replacement cost.
- 2.27.2 The following considerations apply:
- the cost of the modern equivalent asset is at least £100,000;
 - the difference between the replacement cost of the existing asset and that of the modern equivalent asset is at least 25%.

2.27.3 **Use of this adjustment is expected to be exceptional, and any NHSScotland body wishing to use this method should approach the SGHD in the first instance.** The assumptions used must be recorded and agreed with the auditors, particularly where those assumptions relate to differences in quality rather than quantity.

2.27.4 Where these circumstances apply, the replacement cost of the existing asset should be taken as a proportion of the cost of the modern equivalent asset and not the cost of replacing the existing asset. The modern equivalent asset adjustment reduces the cost of the modern equivalent asset to what it would be if it had an output comparable to the existing asset. The accumulated depreciation on the existing asset should be reduced by the same proportion to give the revised NBV. The reduction in the NBV should be charged to the Operating Cost Statement as an impairment and not to the Revaluation Reserve. This is because the reduction is a permanent diminution in the value of the asset (see Section 3.11 on impairments).

2.27.5 The accounting entries are:

Dr	Operating Cost Statement
Cr	Fixed assets
	<i>With the reduction in the replacement cost of the existing asset</i>

Dr	Provision for depreciation account
Cr	Operating Cost Statement
	<i>With the amount of the reduction in the accumulated depreciation on the existing asset</i>

As a result, the net amount charged to the Operating Cost Statement will be the reduction in NBV of the existing asset.

2.28 Capital Grants to Other Bodies

Capital grants are unrequited transfer payments which the recipient has to use for the purposes of procuring or improving fixed assets from which the Health Board's residents will benefit in terms of achieving the its objectives. Expenditure charged to the Operating Cost Statement in respect of capital grants can be scored against the capital resource limit.

2.28.2 Capital grants are essentially a budgeting mechanism whereby funding provided by Health Boards for capital expenditure by external bodies is charged against the Capital Resource Limit (CRL). This is achieved by deducting the revenue expenditure in respect of such funding, which must be charged in the operating cost statement in the period, from the charge against the RRL and adding it to the charge against the CRL in the outturn statements. It must have therefore been accounted for as revenue

expenditure in the period within the definitions of the NHS Scotland Annual Accounts Manual (<http://www.show.scot.nhs.uk/sehd/fpma/manuals.htm>).

- 2.28.3 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.
- 2.28.4 It is important to distinguish between assets created or developed for use by external bodies for the benefit of the Board's residents and those which the board will use itself. Normally capital grants would only apply to the former, as payments to developers in respect of assets used by the board should either be capitalised where they fall within the definition of board ownership or treated in accordance with the guidance on accounting for leases. The board may also fall to be considered lessor of an asset to be used by external bodies.
- 2.28.5 The most important issues to consider are the accounting treatment of the proposed capital grants and agreement by the recipient body. Particular reference should be made to FRS 5 where it is necessary to determine the substance of complex transactions and the Board may wish to take accounting advice. In planning terms the board should develop considered robust proposals in respect of potential capital grants and seek audit opinion before proceeding well in advance of the year end.

3. Valuations – Review and Impairment

3.1 Introduction

- 3.1.1 Valuation of tangible fixed assets is on the basis of historical cost modified to reflect the value of fixed assets by reference to their current cost. The NHS in Scotland adopts a policy of revaluation within the meaning of FRS 15, and must consistently apply revaluation policies to each asset within a given class of assets. A tangible fixed asset's carrying amount at the balance sheet date should be the revalued amount, determined according to these policies. 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 at any event before the end of the financial year in which the asset is acquired or created.
- 3.1.2 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.
- 3.1.3 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. As the last full revaluation was carried out as at 31st March 2004 and a proportion of most NHS bodies subsequently revalued in 2004-05. All remaining properties, however phased, will require to be fully revalued by 31st March 2009. 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. The Scottish Government Health Directorates will continue to supply national indices for equipment and furnishings as previously but no longer intends to issue indices for land or buildings so NHS bodies should make appropriate arrangements with their valuers to adjust values of properties in years between full revaluations.
- 3.1.4 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 31/03/xx.
- 3.1.5 Professional revaluations of individual assets will otherwise be required when:
- there is an indication that tangible fixed assets may have suffered impairment (see 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.

3.2 Assets under construction

3.2.1 **Assets under construction** are revalued in the same way as completed buildings. 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.

3.3 Ad-hoc revaluations

3.3.1 FRS 15 requires that where a tangible fixed asset is revalued, '**all the assets in the same class must be revalued**' (para 61). 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.

3.4 Valuers and Disclosures

3.4.1 Professional Valuers will be commissioned locally by the NHS Board to carry out valuations and to supply indices, as required. The standard disclosure of accounting policies (Note 1) in the Manual for Accounts covers 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 FRS 15 (para 74) must be followed.

3.5 Non-specialised land and buildings

3.5.1 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), as defined in FRS15 Appendix 1, 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.

3.5.2 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.

3.6 Specialised land and buildings

3.6.1 The replacement cost for operational land and buildings is existing use value (as described in Appendix 1 of FRS 15), with the addition of notional directly attributable acquisition costs where material. In the case of specialised properties or properties not normally traded on the open market, valuation

on this basis may be inappropriate and/or impractical, and such property should be valued on the basis of depreciated replacement cost.

- 3.6.2 Certain assumptions inherent in the Depreciated Replacement Cost (DRC) valuation methodology lead to DRC valuations invariably 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 are not taken into account in arriving at DRC. 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.
- 3.6.3 It is therefore to be expected that the revaluing from cost to DRC will lead to an impairment loss which must be recognised in the Operating Cost Statement and therefore charged against the Revenue Resource Limit (RRL). The actual cost of construction must initially be shown as an addition to fixed assets and will therefore be charged against the Capital Resource Limit (CRL).
- 3.6.4 The DRC valuation methodology employed by the Appointed Valuers analyses property by approximately 25 separate 'elements', based on the Building Cost Information Service (BCIS) definitions. Certain elements (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.
- 3.6.5 While NHS bodies may wish to track various elements in their registers separately, 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. 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 major elements of plant may have depreciation lives so different from the structure as to merit treatments as separate assets under FRS 15. 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 FRS 11 terms, whereas the block itself would be).
- 3.6.6 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.

3.7 Equipment

- 3.7.1 Equipment is carried at depreciated replacement cost. In practice, it is sufficient to apply indexation and depreciation to the current value of equipment.

3.8 Indexation

- 3.8.1 Indexation is intended to value assets by reference to current costs without the expense of frequent revaluations. Indexation is simply another means of revaluation but may be identified separately in asset registers. 3.8.3 Indices 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.
- 3.8.2 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 will be issued by SGHD for assets other than land and buildings and 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.
- 3.8.3 All tangible fixed 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 asset's anticipated future use.
- 3.8.4 NHS bodies should always ensure that assets are not sold at undervalue, and so will obtain a valuation to establish a fair price on the date of sale. The valuers should be instructed to provide a market valuation of properties to be sold. This will determine the basis of valuation appropriate to the particular asset for the financial year, as described in section 3.10 below.

3.9 Valuation

- 3.9.1 The adaptation of FRS 15 previously allowed was withdrawn in financial year 2003-04. This means that values to be reported in the accounts should be those at the balance sheet date, normally 31 March. This contrasts with the treatment previously allowed where bodies were allowed to apply prospective indices in order to arrive at values to be reported in the year end accounts.
- 3.9.2 In order to facilitate in-year control of cost of capital charges the following alternative calculation may be used in respect of tangible fixed assets and intangible fixed assets where revalued, or where depreciation or amortisation charges are calculated using opening values. The cost of capital charge will be based on opening values, adjusted pro rata for the following changes in-year:
- plus additional assets and subsequent capital expenditure on existing assets – at cost;
 - less disposals – as value in opening balance sheet (plus any subsequent capital expenditure prior to disposal);
 - less impairments – the amount of the reduction being calculated from the value in the opening balance sheet (plus any subsequent capital expenditure), or the acquisition cost of additional assets as appropriate;

- less depreciation or impairment charge.

3.9.3 The cost of capital charge on other assets and liabilities in the balance sheet should continue to be based on average opening and closing values in the accounts.

3.10 Surplus assets and disposals

- 3.10.1 Properties surplus to requirements should be valued on the basis of open market value, less any directly attributable selling costs where material. Properties surplus to requirements should continue to be disclosed as fixed assets, but, if material, their existence and value should be disclosed separately in a note to the accounts. This should be applied to assets no longer in operational use.
- 3.10.2 Property may be considered as 'expected to become surplus' when a management decision has been taken to dispose of it. The decision is best evidenced by Senior Management Team minutes recording a decision, but auditors may accept other written evidence or representations about the status of property.
- 3.10.3 Where a property or other fixed asset remains in use but is expected to become surplus shortly, the accounting treatment depends upon whether the expected disposal proceeds are anticipated to be less or more than current carrying value. Where the expected disposal proceeds are anticipated to exceed current carrying value, then the asset should be carried at its current value until the first balance-sheet date after it becomes surplus, when it will be revalued to open market value. The converse situation, where expected disposal proceeds are anticipated to be less than current carrying value, is discussed in the Accelerated Depreciation section (3.22).
- 3.10.4 The effect on both the RRL and the CRL of decisions to identify assets as surplus should therefore be considered and reported in the estimates requested by the SGHD.
- 3.10.5 Where accelerated depreciation is to be calculated, the OMV to be used is that of an asset of the same age at the present time and no attempt should be made to predict the OMV at the time of planned disposal. Accelerated depreciation should be calculated by reference to the overall values of the property to be disposed of, including the land. The values of the land and building components of the property should then be reduced to the overall market value of the property to be disposed of. This will normally be achieved by deducting the accelerated depreciation from the building component of the property.

3.11 Impairments

- 3.11.1 An impairment occurs where the recoverable amount of an asset is lower than its carrying amount.
- 3.11.2 The not-for-profit nature of the vast majority of NHS bodies' activities means that value in use is not measurable in terms of income. In these cases, value in use will be assumed to be at least equal to the cost of replacing the service potential provided by the asset, unless there has been a reduction in that 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 overspecified for its current use (e.g. a hardened aircraft hangar used as a store).
- 3.11.3 Any write-down to recoverable amount in the above circumstances will be charged to the operating cost statement. In the case of (a–d) 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. In the case of the example in e, it will be the value of a store – i.e. without the higher specification. Where an asset continues to provide its existing service potential in advance of sale or other event that will reduce its service potential, this is not an impairment and the accounting treatment should follow the normal practice on the review of economic lives of assets and their residual values by taking into account the change in asset life and residual value. 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 be the replacement cost of 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.
- 3.11.4 A review for impairment of a fixed asset should be carried out if, and only if, events or changes in circumstances indicate that there has been an impairment.

3.12 Requirements of FRS 11

- 3.12.1 Much of the detail of FRS 11 is concerned with the identification of 'income-generating units' and the measurement of value in use. For assets dedicated to commercial profit-making services, defined in 7.5(ii) and 7.5(iii) of *The Fees and Charges Guide* (i.e. in competition with the private sector and

expected to earn an average real rate of return of 8 per cent or more), the accounting treatment should follow that suggested by FRS 11, *Impairment of Fixed Assets and Goodwill*. In summary, this means:

- a) value in use is defined as the present value of future cash flows obtainable as a result of an asset's continued use, including those resulting from its ultimate disposal. This differs from the assessment of value in use for non-commercial activities;
- b) a detailed review of assets for impairment should be carried out only if there is some indication of impairment having occurred. Paragraph 10 of FRS 11 lists possible indications of impairment;
- c) impairment which reflects a reduction in the quantum of the service potential of the asset (e.g. physical damage or obsolescence) should be recognised in the operating cost statement. Other impairments should, instead, be written off against the revaluation reserve until the carrying value reaches the level of depreciated historical cost, impairments below that should be recognised in the operating cost statement

3.13 Loss of economic benefits

- 3.13.1 Indications of possible impairment are described in section 3.11 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.
- 3.13.2 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.
- 3.13.3 Where there is a commitment by management to undertake a significant reorganisation and fixed assets are involved, the impact of potential future impairments arising should be estimated.
- 3.13.4 Any impairment (i.e. write down to recoverable amount) in the above circumstances will be charged to the Operating Cost Statement.
- 3.13.5 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.
- 3.13.6 Section 3.2.22 also provides guidance on the accounting treatment that should be adopted in specific circumstances.

3.14 Price Changes

- 3.14.1 Downward revaluations due solely to fluctuations in market value will be identified from valuations provided by the appointed valuer or from indices supplied by the Scottish Government Health Directorates or other alternative methods of valuation deemed appropriate. Downward revaluation due solely to fluctuations in market value will not be charged to the operating cost statement but instead written off against the revaluation

reserve (or donated asset reserve, or government grant reserve, as appropriate), 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 below this should be recognised in the operating cost statement, unless it can be demonstrated that the recoverable amount is greater than the revalued amount, in which case falls can be charged to the statement of recognised gains and losses. For recoverable amount to be greater than the revalued amount, in the case of not-for-profit activities, NHS bodies must demonstrate that:

- a) they are not aware of any factors that have caused a sustained fall in usage or decline in the condition of the asset, i.e. the fall in value has not been caused by a consumption of economic benefits;
- b) for assets valued on an existing use value or other market-based valuation, the reduction is due to a short-term reduction in market prices which informed opinion believes will be reversed in the medium term;
- c) for assets valued on a depreciated replacement cost basis (i.e. where there is no market value), changes in technology in the relevant sector are small, so that any downward movement in prices are likely to be short-term, as there are no noticeable improvements in technology or sustained falls in commodity prices which would cause prices to fall over the medium term; and
- d) if, in a subsequent accounting period, it is decided that any part of the downward movement in price is in fact permanent rather than short-term, then the consequent error in the prior period accounts should be corrected in the current period by debiting the resulting impairment to the operating cost statement and by crediting the revaluation reserve by a corresponding amount.

3.15 Impairment review

- 3.15.1 An indication of impairment does not necessarily mean there has been impairment but it should prompt a review of the value of the asset, its useful life and its residual value (if any).
- 3.15.2 An impairment review compares the carrying amount of an asset with its recoverable amount, where recoverable amount is the higher of net realisable value and value in use.
- 3.15.3 Net realisable value is the amount for which an asset can be disposed of, less any direct selling costs. Direct selling costs include legal costs and the costs of removing a sitting tenant but they do not include reorganisation costs e.g. redundancy costs linked to the sale of a property.

- 3.15.4 FRS 11 defines value in use as the present value of the future cash flows from the asset's continued use. However, it adds that, where a fixed asset is not held for the purpose of generating cash flows, an alternative measure of its service potential may be more relevant. This is to be at least equal to the cost of replacing the service potential provided by the asset. The cost of replacing the service potential of operational assets in the NHS is **existing use value** or, if such a value is not available (as is the case for specialised property) **depreciated replacement cost**.
- 3.15.5 An impairment review of an NHS asset therefore usually compares the carrying amount of the asset with the higher of existing use value/depreciated replacement cost and net realisable value. However, if an asset cannot be used or is surplus to requirements, the impairment review compares the carrying amount of the asset with net realisable value only, since there is no value in use. Where an asset is over-specified for its current use, the impairment review compares the carrying amount of the asset with the higher of net realisable value and the existing use value/depreciated replacement cost of an asset of the lower specification.

3.16 Recognition of impairment losses

- 3.16.1 As in the application of all 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.

3.17 Presentation of impairment losses

- 3.17.1 As detailed in FRS 11, 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.*

3.18 Revaluation Reserve

- 3.18.1 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 assets for these purposes. It would be usual to account for individual blocks (in Valuers' report terms) as separate assets. Certainly, a site is too large a unit of aggregation, while building elements are too small. As a rule of thumb, revaluation reserves

should be linked to individual assets where an asset is a block of property that would tend to be disposed of or enhanced as one single unit.

- 3.18.2 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.

3.19 Measurement and valuation

- 3.19.1 The revaluation reserve reflects the unrealised element of the cumulative balance of indexation and revaluation adjustments to assets except donated assets and assets financed from government grant.
- 3.19.2 A surplus arising on the revaluation of an asset will be credited to the reserve. For fixed assets, any downward revaluation due to fluctuations in market value will be debited to the reserve in prescribed circumstances. A downward revaluation of an asset due to fluctuations in market value will be debited to the reserve except in prescribed circumstances, when it will be debited to the operating cost statement (see 3.14.1). 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. 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.
- 3.19.3 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.
- 3.19.4 On disposal of a revalued asset, the balance on the revaluation reserve in respect of that asset will become fully realised and should be transferred to the general fund.
- 3.19.5 On impairment of a revalued asset, the balance on the 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.
- 3.19.6 The notes to 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.

3.20 Donated assets

- 3.20.1 Similar approaches to those above should be adopted for donated assets, using the Donation Reserve instead of the Revaluation Reserve.
- 3.20.2 The donated asset reserve reflects the net book value of assets which have been donated to NHS bodies.

- 3.20.3 Donated assets are capitalised at current value on receipt and are revalued and depreciated in the same way as purchased assets. The value of donated assets is reflected in the donated asset reserve, which is credited with the value of the original donation and subsequent revaluations. Each year, an amount equal to the depreciation charge is transferred from the reserve to the operating cost statement.
- 3.20.4 On disposal of a donated asset, the profit or loss is taken to the operating cost statement. This is matched by the transfer of an equal amount from the donated asset reserve, so that the net effect on the operating cost statement is nil. The balance on the donated asset reserve in respect of that asset, representing the cash proceeds, will be transferred to the general fund.
- 3.20.5 Where impairment of a donated asset occurs, the loss in value charged to the operating cost statement will be matched by an equivalent amount transferred from the donated asset reserve.
- 3.20.6 The notes to 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.

3.21 Reversal of past impairments

- 3.21.1 A reversal of an impairment loss should be recognised in the Operating Cost Statement to the extent that the original impairment loss (adjusted for subsequent depreciation) was recognised in the Operating Cost Statement. Any remaining balance of the reversal of an impairment should be recognised in the revaluation reserve.
- 3.21.2 Events and circumstances which are the reverse of those listed 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.

3.22 Write-offs for impairments and Accelerated Depreciation

- 3.22.1 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 Annually Managed Expenditure (AME) should be deducted from the charge against the RRL and boards should contact the SGHD to agree eligible impairments. These are also noted below as follows:
- 3.22.2 Damage to tangible fixed 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.

3.22.3 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.

3.22.4 Other eligible impairments that cannot be classified in any of the other 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 and disposals that involve writing down property assets to OMV from DRC, either through accelerated depreciation or immediate impairment for unplanned disposals.
- 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.

3.22.6 Categories of impairment included in the FReM to score as DEL should remain within the charge against the RRL and boards should fund these within their own resources. These are also noted below as follows:

3.22.6 Loss or Damage resulting from normal business operations. All losses of, and damage to, tangible fixed 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.

3.22.12 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.

3.22.12 The unnecessary over-specification of assets 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.

3.22.12 Any proposed treatment of impairments as deductions from the charge against the RRL will need to be fully supported by forecasts identifying each impairment or accelerated depreciation 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 SGHD 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. Calculations of accelerated depreciation by property should also be included. This should agree with information that is subsequently submitted in boards' monthly monitoring returns.

3.23 Impairment Forecasting

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

3.24 Functional Life Adjustment - Accelerated Depreciation

3.24.1 For properties that are expected to become surplus but are still operational, the impact will be over a longer period. Hence the estimated deductions will be spread over future years. The amount notified in year will relate to the expected remaining write down of the asset at that point in time.

3.24.2 Any proposed deductions should be shown for the current financial year only. These should be detailed in the property transactions return that NHS bodies will be required to submit to SGHD and substantiate any impairments by an annual impairment review which will take into account any valuation and timing changes.

3.24.3 Details of accelerated depreciation should include the forecast impact on the Operating Cost Statement over the period before the properties are expected to become non-operational, comparing this to pre-existing depreciation in order to determine the accelerated write down amount per annum.

3.25 Reversal of impairments

3.25.1 The reversal of past impairments through the Operating Cost Statement 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.

3.26 Accounting entries and examples - Revaluation and indexation

- 3.26.1 Following **professional valuation**, the purchase cost of an asset is changed to reflect the new value and the accumulated depreciation becomes zero (by crediting the revaluation reserve). The effect is such that the purchase cost and NBV are equal (at date of valuation - 31 March). The revised purchase cost is then depreciated over the remaining life, only those properties that are fully revalued in the year should be accounted for in this way. Other property revaluations calculated by indices issued by the locally appointed valuers should be treated as indexations, with consequent adjustments to both revalued cost and depreciation.
- 3.26.2 Following **indexation or interim revaluation**, the purchase cost *and* accumulated depreciation of an asset are altered by the new index to give a revised NBV according to the life used. The revised purchase cost continues to be depreciated over the original economic life.
- 3.26.3 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. In the case of a Donated Asset any adjustment will be reflected through the donated asset reserve.
- 3.26.4 A reversal of an impairment loss should be recognised in the operating cost statement to the extent that the original impairment loss (adjusted for subsequent depreciation) was recognised in the operating cost statement. Any remaining balances of the reversal of an impairment should be recognised in the statement of recognised gains and losses.
- 3.26.5 The underlying principle in reversing impairments previously charged to the Operating Cost Statement 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 Operating Cost Statement 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.

Assets Under Construction

- 3.26.6 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.
- 3.26.7 Construction inefficiencies are not valid costs of building and should not be capitalised – they should be written off directly to the Operating Cost Statement.

- 3.26.8 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. When an asset is transferred from AUC to tangible fixed assets, if this results in an impairment, the impairment should be charged to the Operating Cost Statement as a loss of economic benefits. 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.

3.27 Definitions

Existing use value

Depreciated replacement cost (property)

These will be informed by the Appraisal and Valuation Manual (Royal Institution of Chartered Surveyors, quoted in FRS 15).

Historic Cost

Some NHS bodies will not have records of historic cost (HC) of revalued assets. In such cases 'HC' is the value at which the asset first appeared in the balance sheet. This will most likely be the date of the NHS Board's establishment or at the time of the first valuation.

Once established, the historic cost and the life of the asset as estimated at the time give a value for historic cost depreciation that remains constant. Thus a building valued at £1m 5 years ago and given a 20 year life at that point will be recorded as having a historic cost depreciation value of $1,000,000/20 = £50,000$ pa for the next fifteen years. If this year it is revalued at £1.5m and given a 25 year life, the actual depreciation charged for the year will be $1,500,000/25 = £60,000$ pa, giving a transfer for the year from the revaluation reserve to the General Fund of £10,000.

Subsequent expenditure (enhancement) on an asset will have the effect of increasing its 'historic cost'. The historic cost depreciation figure can be re-calculated by adding an element for depreciation on the enhancement (as if it were a separate, new asset) to the original figure.

4. Depreciation and Asset Lives

4.1 Introduction

4.1.1 In accordance with FRS 15, depreciation should be provided for all fixed assets with a finite useful life by allocating the cost (or revalued amount) less estimated residual value of the assets as fairly as possible to the periods expected to benefit from their use. Depreciation of tangible fixed assets is also dealt with in chapter 5 of the FReM.

4.2 Depreciation policy

4.2.1 The FReM does not specify depreciation policies but requires entities within each departmental group to have consistent policies. Following the full implementation of FRS 15 in 2003-04, depreciation of NHSScotland assets should be based on opening values, as permitted by FRS 15. The optional modification to the calculation of cost of capital charges in respect of those assets is discussed in chapter 7. The policies set in accordance with the Accounts Direction to comply with the FReM are outlined below.

4.2.2 The NHS adopts a policy of straight-line depreciation. FRS 15 suggests that this method is usually adopted as a default where the pattern of consumption of economic benefits is uncertain (as it generally is in the NHS specialised estate). This being the policy adopted for the Consolidated Accounts, other methods (eg. reducing balance, sum of digits methods) are not permissible.

4.3 Land and Building Assets

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

4.3.2 Building assets are depreciated over the period of their **assessed 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.

4.3.3 Surplus buildings still in operational use should be depreciated from their carrying values at a rate such that they reach their OMV on the date that they are no longer in operational use. Where this is greater than carrying value, they should not be depreciated and held at their carrying values until the balance sheet date after they become non operational, when they should be revalued to OMV.

4.3.4 Properties that are surplus to requirements and are not in use should be carried at OMV and not depreciated.

4.4 Equipment

4.4.1 Equipment is depreciated over its **useful economic life**. FRS 15 requires a review of expected lives and residual values of equipment to be carried out at the end of each accounting period, which may lead to a departure from

standard lives where expectations of useful economic life are 'significantly different'.

- 4.4.2 FRS 15's instruction is: *'The useful economic life of a tangible fixed asset should be reviewed at the end of each reporting period and revised if expectations are significantly different from previous estimates. If the useful economic life is revised, the carrying amount of the tangible fixed asset at the date of the revision should be depreciated over the revised remaining useful economic life'*

and on residual value:

'Where the residual value is material it should be reviewed at the end of each reporting period to take account of reasonably expected technological changes based on prices prevailing at the date of acquisition (or revaluation). A change in its expected residual value should be accounted for prospectively over the asset's remaining useful economic life, except to the extent that it has been impaired at the balance sheet date'.

- 4.4.3 FRS 15 however only requires a change in the depreciation profile of an asset to be made where the review suggests that a 'significant' adjustment to lives or residual value is appropriate. It is suggested then that NHS bodies standardise lives of equipment assets adopting individual lives only where it is clear that the standard lives are materially inappropriate. 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

- 4.4.4 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 4.4.3 above. In this case, an individual assessment of the asset life will be required and asset depreciated accordingly.

4.5 Residual value

4.5.1 As noted above – the residual value is based on the prices prevailing at the time of purchase or revaluation. *It is not an estimate of how much the asset could be sold for at the end of its useful economic life.* Thus, if an asset has a 6 year estimated useful life, the residual value is the net realisable value of a 6 year old asset at the date of purchase or revaluation. This means, for example, that holding gains cannot be anticipated.

4.6 Assets under construction

4.6.1 Assets under construction are not depreciated, because depreciation is appropriate only when assets are in operational use.

4.7 Intangible fixed assets

4.7.1 Intangible fixed assets are amortised over the period of the assets' expected economic lives.

4.8 Finance leases

4.8.1 Assets leased under finance leases should be depreciated over *the shorter of the primary lease term and the assessed remaining life of the asset.* If the leased asset continues to be used by the lessee after the end of the primary lease term it should be revalued by the Appointed Valuer to its residual value. The residual value should then be depreciated over the remaining useful economic life of the asset.

4.9 Chargeable period

4.9.1 NHS bodies have the option to calculate depreciation 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.

4.10 Availability for use

4.10.1 Depreciation is chargeable on assets from the start of the period following the period in which the asset first became available for use.

4.10.2 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.

4.10.3 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).

4.11 Disposals and surplus assets

4.11.1 Depreciation ceases to be chargeable when an asset is disposed. Disposal 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, eg 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.

4.11.2 Depreciation also ceases to be payable when an asset is formally declared as surplus, is taken out of operational use, and is revalued to open market value for alternative use, but has not yet been disposed of.

4.12 Transfer of an asset under construction to use

4.12.1 Assets under construction are not subject to depreciation, but when they become available for use they must be reclassified as buildings or equipment.

4.13 Functional life adjustment – accelerated depreciation

4.13.1 The situation often arises where an asset remains in operational use although it is scheduled for disposal. This fact does not itself indicate impairment, but does affect the life and depreciation profile of the asset, as outlined below.

4.13.2 If there are firm plans to dispose of a currently operational building, NHS bodies should establish the market value of the plot to be disposed of. This will effectively form the revised residual value of the site and the excess of current carrying value over this should be depreciated over the remaining expected period of operational use. In practice this will likely result in accelerated depreciation charged to write the asset down to its open market value unless this happens to be higher than its carrying value, which is unusual for properties valued at DRC.

4.13.3 The point in time at which accelerated depreciation should be applied will depend on what stage the plans for disposal have reached. Generally it should be taken to mean that point in time that the disposal is deemed more likely than not to go ahead. This should be evidenced by an assessment of the relevant risk factors influencing the plans to support the timing adopted. The increased depreciation must be included in capital charges and identified as an impairment eligible for deduction from the charge against the RRL.

- 4.13.4 In the unlikely event that the open market disposal value exceeds the current carrying amount, it should be carried at its current value and not depreciated until the balance sheet date after which it becomes non-operational, as outlined above. The revaluation to OMV on taking the asset out of use, and prior to disposal will then result in a revaluation gain.

4.14 Disposal of a surplus asset

- 4.14.1 Depreciation is chargeable in the period in which disposal of an asset takes place. Depreciation is also chargeable in the period in which a building is identified as surplus and is still in operational use where it is required to reduce the carrying value of the building to its Open Market Value. No further depreciation is charged on a surplus building asset after this point *provided* that it is not in operational use.

4.15 Collective assets

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

4.16 Fully depreciated assets

- 4.16.1 When an asset reaches the end of its useful economic life it is fully depreciated, giving a nil net book value. If it continues to be used, no adjustment is made in the books and its cost and full depreciation continue to be carried (though the net of these two is nil), 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.
- 4.16.2 The necessity to adopt this treatment should be rare in future, as estimates of useful economic life are required to be made regularly.

4.17 Long-life assets

- 4.17.1 FRS 15 recognises that some assets with very long lives and/or high residual values will attract immaterial levels of depreciation. In the NHS all assets, including ones falling into this category, should be depreciated as a matter of policy to achieve consistency.
- 4.17.2 If the estimated remaining useful economic life of a tangible fixed asset (other than non-depreciating land) exceeds 50 years, the asset should be reviewed for impairment, in accordance with FRS 11, at the end of each reporting period.

4.18 Infrastructure assets

- 4.18.1 Infrastructure assets are defined in the FReM as being 'assets that form part of an integrated network servicing a significant geographical area, for example road networks'. It is very unlikely that infrastructure assets, as defined in FRS 15 and chapter 5 of the FReM, will be found in the NHS. NHS bodies should however contact the Scottish Government Health Directorates

to discuss the accounting treatment to be adopted where it is believed that renewals accounting may be appropriate.

4.19 Heritage assets

- 4.19.1 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 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 and individual works of art lying outside main national collections are unlikely to merit this classification.
- 4.19.2 **Non-operational heritage assets** are those that are held primarily for the purpose outlined in 4.19.1 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 the Scottish Government Health Directorates.
- 4.19.3 **Operational heritage assets**, as defined in chapter 5 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 (eg buildings)'. These assets should be treated as any other type of tangible fixed asset in terms of valuation, depreciation and capital charges.
- #### 4.20 Depreciation calculation - On revalued assets
- 4.20.1 The FReM specifies that all the depreciation chargeable on revalued assets must pass through 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 revaluation on depreciation will not be accounted for until future periods. Effectively the change in depreciation resulting from year end revaluation is taken directly to the revaluation reserve in the period of the revaluation.
- 4.20.2 NHS bodies should release an amount from the **revaluation reserve** to the **General fund** in respect of this excess 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.
- 4.20.3 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

4.20.5 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	Fixed assets – Gross cost – revaluation	11	
Cr	Fixed assets – Accumulated depreciation – revaluation		4
Cr	Revaluation reserve		7
	<i>To record revaluation</i>		

Dr	Operating Cost Statement- depreciation charge for the year	22	
Cr	Fixed assets – Accumulated depreciation – YTD depreciation		22
	<i>Depreciation charge for the year</i>		

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

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.

5. Disposal Of Fixed Assets

5.1 Introduction

5.1.1 Where a tangible fixed 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.

5.2 Accounting

5.2.1 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 charged (or debited) to a 'Sale of Asset Account'. The balances for accumulated indexation and revaluation in respect of assets disposed of in the year should be transferred from the Revaluation Reserve to the General Fund.

5.2.2 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.

5.3 Budgeting

5.3.1 The net book value of fixed 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 SGHD. This may result in a situation where the CRL is negative because this capital income is greater than capital expenditure.

5.3.2 The profit or loss on disposal of fixed assets will be carried to the operating cost statement and shall therefore be included in arriving at the net operating costs. This element should be removed in calculating the outturn against the RRL and transferred to the outturn against the CRL.

5.3.3 Where an NHS body previously agreed with SGHD to utilise specific anticipated net profit on disposal of fixed assets for specific purposes within their financial plans, they should advise the SGHD of the additional revenue expenditure that can no longer be funded from this source. .

5.3.4 Conversely, where a NHS body previously requested additional funding in respect of a net loss on disposal of fixed assets or impairment of property, they will no longer require it.

5.3.5 It should be stressed that, under normal circumstances, a NHS body would not be entitled to additional funding in respect of profits on disposal now treated as capital income.

5.3.6 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 SGHD of any disposals of fixed assets.

Example 2: Sale of land and buildings by Health Body:

5.3.7 The Health Body 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:

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

	<i>Disposal of asset – removal of NBV</i>
Dr	Sale of Asset Account
Cr	Fixed Assets – Cost
	With asset cost of £200k

Dr	Fixed Assets – 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 fixed assets’. However this will now be added back to net operating costs in the statement of revenue resource outturn and deducted from net capital expenditure in the statement of capital outturn.

5.4 Timing of Disposal

5.4.1 The timing of disposal of a fixed asset will be determined in accordance with the guidance in section 4.11.1, which will inform the depreciation charge required.

5.4.2 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 capital charges.

5.4.3 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. For example, if the price has not been fully agreed or final planning permission is outstanding, it is likely that it would not be appropriate to recognise the disposal.

Transfer of Ownership

- 5.4.4 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 depreciation 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 Fixed Assets

- 5.4.5 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.
- 5.4.6 In the period of disposal, depreciation 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.

Example 3: Sale of Equipment by a Health Body

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

A health body has a piece of equipment with a replacement cost of £10,000. At that date it 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

$$= 500 - 3,000 = (2,500) \text{ i.e. a loss of } 2,500$$

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

6. Leases

6.1 Introduction

- 6.1.1 In addressing the accounting treatment for leases and hire purchase transactions, SSAP 21 *Accounting for Leases and Hire Purchase Contracts* sought to improve 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.
- 6.1.2 In the NHS the main impact of SSAP 21 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.
- 6.1.3 SSAP 21 needs to be considered alongside FRS 5 *Reporting the Substance of Transactions* and the Treasury Guidance Note on FRS 5 in dealing with more complex or PFI transactions. FRS 5 gives way to any SSAP or FRS containing more specific guidance, and so SSAP 21 is appropriate for single transactions, while wider complex arrangements invoke FRS 5. Both the SSAP and FRS follow the 'substance over form' principle and in complex related transactions (eg 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.
- 6.1.4 This is described in section 5 of the FReM.
- 6.1.5 Chapter 9 on PFI transactions lists some quantitative and qualitative indicators that may be of use in helping define lease types.
- 6.1.6 The ASB Discussion Paper *'Leases: Implementation of a New Approach'* is mentioned at the end of the Chapter: any subsequent FRS arising from these proposals will require major revisions to NHS capital accounting policy.

6.2 Leasing arrangements between NHS bodies

- 6.2.1 To comply with UK GAAP, 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

6.3 Lease

- 6.3.1 *'A lease is a contract between two parties (the lessor and lessee) for the hire of a specific asset. The lessor owns the asset, but conveys the right to use the asset to the lessee for an agreed period of time in return for the payment of specified rentals.'*

6.4 Finance lease

6.4.1 A finance lease is a lease *'that transfers substantially all the risks and rewards of ownership of an asset to the lessee'*.

6.5 Operating lease

6.5.1 *'a lease other than a finance lease'*.

6.6 The lease term

6.6.1 This *'is the period for which the lessee has contracted to lease the asset and any further terms for which the lessee has the option to continue to lease the asset, with or without payment, which option it is reasonably certain at the inception of the lease that the lessee will exercise'*. 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 for the purposes of the 90% test (see below) 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 90% test if it is not material.

6.7 Fair value

6.7.1 'The price at which an asset could be exchanged in an arm's length transaction less, where applicable, any grants receivable towards the purchase or use of the asset'. In applying the 90% test, if this value is not known, an estimate may be used.

6.8 Determining the lease type - the 90% test

6.8.1 This test is not definitive: UK GAAP notes a move towards more qualitative tests in deciding whether risks and rewards of ownership have been transferred, with the 90% test being just one factor. It suggests that FRS 5 leans towards the approach of considering the factors affecting economic substance of a transaction. NHS bodies are encouraged then to look more widely at all the factors surrounding the terms of a lease, given the narrow deterministic nature of the 90% test.

6.8.2 Under the 90% test, a finance lease is deemed to exist if the Present Value (PV) of the minimum lease payments over the period of the lease amounts to substantially all (i.e. in excess of 90%) of the fair value of the leased asset.

6.8.3 **Minimum lease payments** may comprise (depending on the intended use of the minimum lease calculation):

- (a) the minimum payments over the remaining part of the lease term;
- (b) any residual amount guaranteed by the lessee or a party related to him; and,

(c) any residual amounts guaranteed by any other party.

6.8.4 In the calculation of the **implicit interest rate** for the 90% test, all the above components (a), (b) & (c) are used. The **lessor** will use all the components (a), (b) & (c) in his 90% test. The **lessee** uses (a) and (b) only in his 90% calculation.

6.8.5 The **implicit interest rate** is the discount rate that '*at the inception of the lease, when applied to the amounts which the lessor expects to receive and retain, produces an amount (the present value) equal to the fair value of the leased asset*'. The '*amounts the lessor expects to receive and retain*' are:

- (1) the minimum lease payments to the lessor [(a), (b) & (c) above] plus
- (2) any unguaranteed residual value: less
- (3) any amounts included in (1) & (2) for which the lessor will be accountable to the lessee.

6.8.6 The lessee may not be in possession of the full details, as the lessor is likely to be, to calculate the implicit interest rate. In these circumstances, estimates may be made of the amounts the lessor expects to receive, or failing that, the rate that the lessee would expect to pay on a similar lease may be used. UK GAAP suggests that where this is not known, the lessee's rate of incremental borrowing should be used.

6.8.7 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 3.5% + current inflation.

6.8.8 In applying the 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 under 90% to 'prove' the existence of an operating lease. It is perfectly possible for transactions returning a lower PV than 90% to be finance leases in substance and vice versa. Other indicators are noted below.

6.9 Determining the Lease Type – Other Factors

6.9.1 UK GAAP notes that affirmative answers to the following questions would tend to indicate that a finance lease exists:

- (1) if the lessee can cancel the lease, will he bear any losses associated with the cancellation?
- (2) will the lessee gain or lose from any fluctuations in the market value of the residual? For example, the lessee could receive a rental rebate equalling most of the sale proceeds at the end of the lease.

- (3) does the lessee have the ability to continue to lease the asset for a secondary term at a nominal rental?
- (4) is the expected lease term equal to substantially all of the asset's expected useful life?
- (5) are the leased assets of a specialised nature such that only the lessee (or a limited number of other parties) can use them without major modifications being made?

6.9.2 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.

6.10 Property leases

6.10.1 The principles outlined above apply equally to property leases. Some specific considerations are noted below.

6.11 Statutory rights of renewal

6.11.1 The lease agreement may contain an 'option to renew' clause. With such an option to renew, the extension provisions could give rise to the possibility of a primary lease term approaching or equal to the physical life of the building in some cases. For leased property assets, unless for operational reasons the contrary is apparent, it should be assumed that, where available, renewal of the lease will be exercised at the end of the primary lease term. The lessee's intentions with regard to continued occupation are not always clear at the inception of the lease. Where the lessee has a clear intention not to occupy the building after the initial contractual period expires, eg when a new building is being constructed or services relocated, then the lessee is regarded as having waived his option to renew. Where the lessee is unable to clarify his intentions one way or the other the assumption by default, in the absence of any contrary information, is that the occupation will continue with the right of renewal being invoked on the next occasion.

6.12 Break clauses

6.12.1 The existence of a break clause in what appears to be a finance lease can be sufficient to make it an operating lease where the power to break lies only with the landlord. If, on the other hand, only the lessee has the power to exercise the break clause, this should be considered along with all other factors to decide whether the lease can be classified as an operating lease or a finance lease.

6.13 Short Term Hire of Property

- 6.13.1 Short-term hire of property for a period considerably less than the remaining life, eg 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. Also a property lease may be an operating lease if the purpose for which the asset is used is not a main core use. Leases of parts of a building where the landlord is responsible for repairs to the structure, but does not impose a service charge for this, are likely to be regarded as operating leases. Leases where the landlord would be expected to be able to obtain possession for their own purposes, eg parts of former health centres disposed of to GPs and leased back, are likely to be regarded as operating leases. In all cases the classification will depend on the substance of the lease agreement over the form, in accordance with FRS 5.

6.14 Accounting for finance leases – lessees

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

6.15 Capitalisation

- 6.15.1 The leased asset should be first recorded in the lessee NHS body's books and asset register at the present value of the minimum lease payments. In practice, the present value of the minimum lease payments in a finance lease will normally be at least 90% of the fair value of the leased asset and it is therefore acceptable to record the leased asset in the NHS body's books and asset register at its fair value, i.e. at valuation (land and buildings), or replacement cost (equipment).
- 6.15.2 The date the asset is capitalised will be the date the asset becomes operational. Where a contractual commitment is entered into in advance of the operational date, a disclosure must be made in the Notes to the Accounts.

6.16 Revaluation

- 6.16.1 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 open market valuation for existing use.
- 6.16.2 The appointed Valuer will carry out revaluation of leased land and buildings. NHS bodies must also revalue land and buildings with indications of impairment per chapter 5 of the FReM. Valuation gains and losses will be treated as for owned assets, applying the provisions of FRS 11 as outlined in Chapter 2.

6.17 Indexation

- 6.17.1 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 SGHD should be used where they are considered appropriate.

6.18 Depreciation

- 6.18.1 The leased asset must be depreciated on a straight line basis, over the shorter of the lease term and the assessed remaining life of the asset (the secondary lease period is included in the lease term if it is reasonably certain that the lessee will exercise an extension option).
- 6.18.2 Leased land and 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 land has an infinite life and 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.
- 6.18.3 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.
- 6.18.4 Depreciation is charged from the beginning of the quarter following the date at which the lease is acquired. It is also charged in the quarter 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.
- 6.18.5 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, but matched by a transfer from the revaluation reserve to the credit of the General Fund (where any positive revaluation reserve still remains in respect of the asset).

6.19 Finance lease creditor

- 6.19.1 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 creditor balance and opening NBV of the leased asset will therefore be equal. The lease creditor balance will be reduced each year by the amount of the capital element of the annual rental payment, and must be shown in the Creditors note to the Accounts, analysed between creditors due within one year and creditors due after more than one year.

6.20 Finance charges

- 6.20.1 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. The finance charge should be allocated to accounting periods to

produce a constant rate of interest on the outstanding balance, 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:

$$\text{sum of digits} = (n(n+1))/2$$

where n is the number of rentals. The finance charge can then be allocated to accounting periods using the following formula:

$$\text{Number of rentals remaining/total number of rentals} \times \text{Total finance charge} = \text{Finance charge for period}$$

For example, in the first year the finance charge will be $(10/55) \times £5,000 = £909$, in the following year it will be $(9/55) \times £5,000 = £818$, 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 $(9/45) \times £5,000 = £1,000$ 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 contact SGHD 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 SSAP 21 for an explanation of this method of apportioning finance charges to accounting periods.

6.21 Rental payments

- 6.21.1 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.
- 6.21.2 The NBV and lease creditor 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.
- 6.21.3 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 (ie the finance charge). The finance charge is the same in each period if the straight-line method of apportionment is used.

6.22 Cost of Capital

- 6.22.1 Finance lease assets are effectively *excluded* from the calculation of net relevant assets in the cost of capital calculation due to the deduction of corresponding liabilities (i.e. finance lease creditors). However where such assets are subsequently revalued the resulting difference between the revised asset value and lease creditor will impact on the cost of capital calculation (see Chapter 7, Capital Charges).

6.23 Improvements to leased assets

- 6.23.1 Normal repair and maintenance expenditure on a leased asset should be charged to revenue. Expenditure can be capitalised where it involves renovation or upgrading which has enhanced or improved the asset. The improvements 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 'improvements' 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. Enhancement expenditure is discussed in more detail in Chapter 2.14.
- 6.23.2 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 FRS 5 and SSAP 21.

6.24 Termination of lease

- 6.24.1 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 creditor, with any final cash settlement.

6.25 Operating Leases

Operating lease incentives

- 6.25.1 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 or 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). Alternatively, initial periods of the lease term may be agreed to be rent-free or at a reduced rent.
- 6.25.2 UITF Abstract 28 addresses the issue. The consensus treatment is that the lessee should recognise the aggregate benefit of incentives as a reduction of rental expense. 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. The allocation should be on a straight-line basis unless another systematic basis is more representative of the time pattern of the lessee's benefit from the use of the leased asset.

6.26 RRL/CRL Treatment for Leases

- 6.26.1 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.

6.27 Accounting for leases – lessors

- 6.27.1 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. 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 and included in 'average relevant net assets'.
- 6.27.2 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.
- 6.27.3 In certain cases where leasehold agreements have resulted in full consideration (by means of a capital receipt) being received 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 or recognise a rate of return on the asset. 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.
- 6.27.4 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 and the cost of capital charge on the asset) against the overall benefits received from the lessee. These benefits may be of a non-financial nature.

6.28 Hire purchase contracts

- 6.28.1 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.

6.29 Accounting entries for finance leases

Capitalisation of leased asset

Dr	Tangible fixed assets
Cr	Creditors
	<i>With the present value of total minimum lease payments (or fair value of asset)</i>

Depreciation of leased asset

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

Payment of rental to lessor

Dr	Creditors
Cr	Cash/bank
	<i>With the capital element of rental payment</i>

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

Revaluation of leased assets

Dr	Tangible fixed assets
Cr	Provision for depreciation account
Cr	Revaluation reserve

	<i>With net increase in value (no adjustment of finance lease creditors)</i>
--	------------------------------------------------------------------------------

Expiry of lease

Dr	Provision for depreciation
Cr	Tangible fixed assets
	<i>With accumulated depreciation – sets NBV to zero as asset has been fully depreciated over the lease term.</i>

Continuation of lease after primary lease term

Dr	Tangible fixed assets
Cr	Revaluation reserve
	<i>With residual value, calculated or on valuation.</i>

Depreciation in secondary lease term

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

Rental payment in secondary lease term

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

Example 4: Finance Lease – Example Calculations

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

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

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

7. Capital Charges

7.1 Introduction

Capital charges

7.1.1 For NHS bodies in Scotland, capital charges are taken to mean:

- Depreciation and amortisation charged annually to the Operating Cost Statement; and
- A return on the cost of capital.

7.1.2 Depreciation is dealt with in Chapter 4, and the cost of capital charge is dealt with in Chapter 3.9.

7.2 Background

7.2.1 The present system for the treatment of capital in the NHS was introduced on 1 April 1991, subsequent to the White Paper 'Working for Patients'.

7.2.2 The objectives of capital charging are to:

- promote an awareness of the true costs of capital;
- improve decision making on asset acquisition and disposal;
- promote an efficient use of assets; and
- recognise the cost of capital.

7.2.3 Capital charges reflect the costs of capital which are:

- the wearing out of assets - **depreciation**; and
- the money tied up in assets and not available for use elsewhere - **cost of capital**.

7.2.4 Under section 4.5.3 of the FReM, all NHSScotland bodies are required to earn a return (currently 3.5%) on their relevant net assets in line with Government Departments.

7.3 Capital charges estimates (CCEs)

7.3.1 The SGHD requires all health bodies to submit estimates of the financial impact of property transactions and Capital Charges each year. This will include a 2 year forecast of property transactions, including impairment and accelerated depreciation.

7.3.2 These estimates are a useful budgetary tool for the service and are collected by the SGHD for information purposes. The information on property transactions is used by the SGHD to assess the potential impact on the Health Budget for the current and forthcoming year.

7.4 Cost of capital charge – the calculation

7.4.1 The following balances are excluded from the calculation, as the cost of capital charge will be nil per section 4.5.10 and 4.5.11 of the FReM: -

- Balances with OPG;
- General Fund Debtor or Creditor balances; and
- Donated assets are excluded because they are not financed from exchequer funds and the necessity to earn a return on them might be expected to deter similar donations in the future.

7.4.2 The charge for each item will be based on the average net book value in accordance with section 4.5.12 of the FReM, as amended by the alternative calculation discussed below.

7.4.3 The alternative calculation of the cost of capital charge permitted in section 4.5.13 of the FReM (see 3.9.2 in this manual for details) should be adopted by NHSScotland bodies. This effectively removes the impact of year end revaluation or indexation from the calculation of the cost of capital charge on tangible fixed assets. The pro rating of other in year changes can be approximated by taking the average of the opening balances and the closing balances, excluding revaluation or indexation for the current year. Alternatively bodies may apply averages over a shorter period, as described in the FReM.

7.4.4 Further to the dissolution of NHS Trusts, cost of capital charges will not be transferred in cash. Instead, the cost of capital charge will be debited (credited if negative) to the operating cost statement and credited (debited if negative) to the general fund. A negative cost of capital should be netted off against expenditure on the operating cost statement rather than shown as miscellaneous income.

8. Donated Assets

8.1 Introduction

8.1.1 This chapter gives more detail on accounting for the acquisition, depreciation and disposal of donated assets and expands on guidance given in section 5.2.12 – 5.2.15 of the FReM.

8.1.2 Assets donated by third parties, either by way of a gift or by way of funds to buy the asset, will be accounted for differently from other fixed assets, provided they meet the criteria in 8.1.5. They should be capitalised at current value on receipt. Where the values of the services provided by the asset is over specified for its intended use, the lower value should be used.

8.1.3 Donated assets should be revalued, depreciated and subject to impairment in the same way as other fixed assets. Revaluations should be taken to the donated asset reserve (see 8.6). Each year an amount equal to the depreciation charge on the asset and any impairment should be released from the donated asset reserve to the operating cost statement; there will be no cost of capital charge.

8.1.4 Where a donor contributes part of the cost of a fixed 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 Body's accounts.

8.1.5 To qualify as a donated asset for this treatment:

- there should be no consideration given in return;
- capital charges, if imposed, would reasonably be expected to deter prospective donors from offering such assets in future.

Assets which do not pass both criteria should be capitalised at their current value, the amount capitalised should be credited to the general fund.

8.1.6 The following are examples of what will not qualify as donated assets:

- asset transferred between public authorities as a result of a transfer of functions (unless the asset was originally donated to the transferor body);
- government grants intended as a contribution towards expenditure on a fixed asset;
- subsequent capitalised expenditure on a donated asset which is capitalised (see 2.14) – only the original donation will continue to be accounted for, as in 8.1.3;

8.1.7 Where a donor imposes restrictions on the use of a donated asset, or an asset acquired for no consideration but which fails the donated asset test in 8.1.5, details of the restrictions should be disclosed in a note to the accounts.

8.2 Accounting for donated assets

Capitalisation

8.2.1 The provisions in Chapter 2 of this manual apply: essentially, donated assets are valued on precisely the same basis as purchased assets; their being carried at cost, DRC or market valuation as appropriate. It is necessary to be able to identify donated assets separately from purchased, to enable disposals and impairments to be correctly accounted for.

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

8.3 Revenue expenditure

8.3.1 Where donations are of assets that fall below the normal capitalisation thresholds, 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 fixed assets note. Revenue donations should be credited to an Endowment Account and not to the accounts of health bodies.

8.4 Improvements to donated assets

8.4.1 The normal rules on the capitalisation of enhancement 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 attracts capital charges. It does not give rise to any donation reserve transactions. Any impairment will need to be apportioned between purchased and donated elements, because of their different treatments.

8.5 Financial Target Performance

8.5.1 As shown in section 7.4.1, donated assets are not included in the calculation of average relevant net assets.

8.6 Donation reserve

8.6.1 The donation reserve is maintained to represent the financing associated with the receipt of a donated asset and to provide a mechanism for neutralising depreciation, impairments or profit/loss on disposal charged to the OCS in respect of donated assets (a transfer from the reserve to OCS is made to match the OCS charge).

8.6.2 The donation reserve is used to account for the following transactions involving donated assets.

- On **revaluation** of donated assets, the debit or credit is taken to the donation reserve, not the revaluation reserve;
- On **impairment** of donated assets, the principles outlined in Chapter 3 of this manual and the FReM will apply. Donated assets are analysed with purchased assets in the notes to the Accounts, and impairments need to be recorded against donated assets as normal.

For the sake of consistency, impairments of donated assets should be calculated and accounted for as for purchased assets. Where impairment of donated asset occurs, the loss in value charged to the operating cost statement is matched by an equivalent amount transferred from the donated asset reserve

- **Depreciation** is charged to the OCS in exactly the same way as would the depreciation on a purchased asset. It is chargeable from the quarter following the date of acquisition, and in the quarter of disposal. A transfer is made from the donation reserve to the OCS to match the depreciation charged. No release is made in respect of revalued amounts to the General Fund (as for purchased revalued assets) as the full credit is required in the current year OCS to neutralise the charge.

8.7 Disposal of donated assets

- 8.7.1 Where equipment is taken out of productive use, its value should be written down to its recoverable amount, which (as the asset is not in use) will be its net realisable value. The valuation fall is analogous to the recognition that the asset has been under-depreciated during its period of use.
- 8.7.2 Surplus land and buildings *not in operational use* should be revalued to open market value for alternative use.
- 8.7.3 Property classed as surplus, but still in operational use, *must not* be written down to OMV for alternative use. It should remain in the balance sheet at its normal operational valuation (DRC, or OMV as appropriate). The depreciation charge should however be adjusted such that the asset is full depreciated to its disposal OMV over its remaining life. This accelerated depreciation is again matched by transfers from the donation reserve to the current OCS.
- 8.7.4 Profit or loss on disposal are calculated in the normal way, as the difference between the carrying amount and net sale proceeds, and credited or charged to the OCS. On disposal of a donated asset, the profit or loss is taken to the operating cost statement. This is matched by the transfer of an equal amount from the donated asset reserve, so that the net effect is nil. The net result of this transaction is to re-state the donation reserve such that it is equal to the value of the sale proceeds.

8.8 Realised donations

- 8.8.1 If the covenants around the original donation require that if the asset is sold it must be replaced by another **specified** fixed asset, the donation reserve is maintained.
- 8.8.2 If, however, the covenants around the original donation state that any sales proceeds should be kept by the NHS Body, a transfer to clear any remaining amount in respect of that asset should be made from the donation reserve to the General Fund.

8.9 Accounting entries for donated assets

Acquisition of donated asset

Dr	Tangible fixed assets (donated)
Cr	Donation reserve
	<i>With cost, DRC, or market valuation (equipment at cost)</i>

Depreciation of donated asset

Dr	OCS (expenditure)
Cr	Provision for depreciation account
	<i>With full depreciation charge for period, including on revalued amount</i>

Dr	Donation reserve
Cr	OCS (income)
	<i>With the same amount as charged to OCS above</i>

Revaluation of donated asset (price change)

Dr	Tangible fixed assets (donated)
Cr	Provision for depreciation account
Cr	Donation reserve
	<i>With net increase in value</i>

Entries reversed if there is a fall in value on revaluation (and see impairments)

Impairment of donated asset

Dr	OCS
Cr	Tangible fixed assets (donated)
	<i>With fall in value</i>

Dr	Donation reserve
Cr	OCS
	<i>With the same amount</i>

Disposal of donated asset – closure of asset account

Dr	Asset disposals account
Cr	Tangible fixed assets (donated)
	<i>With asset valuation</i>

Dr	Cumulative depreciation account
Cr	Asset disposals account
	<i>With the accumulated depreciation</i>

Disposal of donated asset – sale proceeds, profit/loss on disposal

Dr	Cash
Cr	Asset disposals account
	<i>With sale proceeds (if to be kept by Board)</i>

Dr	Asset disposals account
Cr	OCS
	<i>With profit on disposal (entries reversed for loss on disposal)</i>

Dr	OCS
Cr	Donation reserve
	<i>With the same profit as posted above to I&E (entries reversed for loss on disposal)</i>

Dr	Donation reserve
Cr	General Fund
	<i>With the remaining reserve balance – this now equals the sale proceeds</i>

9. Private Finance Initiative

9.1 Introduction

9.1.1 The objective of the PFI is to harness the benefits of private sector management in delivering services and fixed assets to the public sector. FRS 5 Application Note F covers contracts where a property is required to fulfil a contract for services. A simple contract for services does not meet the definition of PFI.

9.1.2 The various transactions that comprise a PFI project differ from 'routine' NHS accounting only by virtue of their novelty and complexity. UK GAAP applies equally to PFI accounting and so the provisions on capital accounting contained in this Manual, and the guidance in chapter 5 of the FReM, apply in full to PFI transactions. Specific relevant PFI accounting guidance is to be found in:

- Accounting Standards Board – ASB Application Note 'Amendment to FRS 5 – Reporting the Substance of Transactions: Private Finance Initiative and Similar Contracts' (September 1998). To confirm current guidance please check the ASB web site - <http://www.asb.org.uk/>
- Treasury Taskforce Technical Note No 1 (Revised) 'How to Account for PFI Transactions' (July 1999). To confirm current Treasury Taskforce guidance please check the Treasury web site - <http://www.treasury-projects-taskforce.gov.uk>.

9.1.3 The specialised and complex nature of PFI accounting is addressed in detail in guidance issued by HM Treasury and the Private Finance and Capital Unit (PFCU) in the Scottish Executive. The PFCU is a small unit within the Scottish Executive that aims to provide guidance and support to both the public and private sectors on PFI in Scotland. General enquiries should be addressed in the first instance to the PFCU or via their web site <http://www.scotland.gov.uk/pfi/> 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.

9.1.4 Given the complex nature of PFI projects, NHS bodies entering into such projects should consult fully with the SGHD over the funding issues and technical accounting requirements.

9.1.5 The nature and extent of PFI 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.

9.1.6 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.

9.2 FRS 5 or SSAP 21

9.2.1 The accounting treatment of PFI projects will normally be covered by SSAP 21 or FRS 5. SSAP 21 covers lease accounting and details the categorisation of leases into 'finance' or 'operating'. Chapter 6 of this Manual discusses lease accounting. In the PFI 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 SSAP 21 in isolation to individual transactions. Rather, FRS 5 should be applied and the substance of the transactions as a whole considered.

9.2.2 Similarly, if a PFI contract's elements are separable such that service elements can be identified and valued, the remaining property element is subjected to SSAP 21 analysis.

9.3 Key Questions

9.3.1 The key questions which should be asked in determining whether SSAP 21 or FRS 5 should be applied to a PFI project are highlighted in HM Treasury's Technical Note 1. These should be applied to PFI transactions being considered by NHSScotland bodies.

9.4 PFI Accounting: Separation of contract elements

9.4.1 The first stage of the accounting analysis is to determine if the PFI contract is separable (i.e. the commercial effect is that the individual elements of the PFI payments operate independently from each other). 'Operate independently' means that the elements behave differently and can therefore be separately identified. Any such separable elements that relate solely to services should be excluded when determining which party has the asset of property.

9.4.2 The Technical Note gives examples of separable and non-separable contracts. Some common elements of contracts may be considered separable. These include benchmarked services (where price adjustments can be made, usually every five years) and pass through costs such as utilities and insurance costs. Having excluded any separable service elements PFI contracts can then be classified into:

- Those where the only remaining elements are payments for property. These will be akin to a lease and SSAP 21 should be applied; or,
- Other contracts, where the remaining elements include some services. These contracts will fall directly within FRS 5 rather than SSAP 21.

9.5 Application of FRS 5

9.5.1 For those assets that fall to be considered under FRS 5, whether a party has an asset of the property will depend on whether it has access to the benefits of the asset and exposure to the associated risks. This will be reflected in the extent to which each party bears the potential variations in property

profits or losses. The principle is to distinguish potential variations in costs and revenues that flow from features of the property from those that do not (and which therefore are not relevant to determining who has the asset of the property).

9.6 Quantitative risk

9.6.1 In **quantitative** risk analyses the private sector should be treated as one single entity (so the contractor's laying off risks to other private sector entities will not affect the comparative risk analysis). The potential variations in property profits must be evaluated in NPV terms using the real discount rate used by Treasury in the evaluation of public sector projects (currently 3.5%).

9.6.2 The Technical Note discusses the following types of risk in quantitative terms:

- Demand risk
- Design risk
- Construction risk (this risk is not relevant to the accounting treatment as it does not relate to the operational phase)
- Penalties for under-performance or non-availability
- Potential changes in relevant costs
- Obsolescence and changes in technology
- Residual value risk

9.6.3 In general, if the majority of overall risk is borne primarily by the NHS body, the property is likely to be deemed an asset of that body. The FRS 5 Application Note discusses the above in more detail and should be read by any NHS body entering into a PFI project. A copy of the relevant section is available in Appendix I. A full quantitative analysis should be prepared, by financial advisers, using the preferred bidders' model and Monte Carlo modelling software. This determines the relative proportion of risk borne by the public body and the contractor.

9.7 Qualitative Indicators

9.7.1 As well as a quantified analysis, accounting treatment is also based on consideration of qualitative indicators. These include the following:

- Termination for operator default
- Nature of operator's financing
- Who determines the nature of the property

The FRS 5 Application Note discusses the above in detail, and the relevant section is shown in Appendix II.

9.8 Audit Input

The Treasury Taskforce Technical Note No.1 identifies the 3 stages at which audit comment should be sought on the accounting treatment. The three stages are Pre-Invitation to negotiate, Appointment of preferred bidder and Pre-contract signature. NHS bodies should seek to determine audit comment on their proposed accounting treatment before financial close. Engaging the external auditor in this process earlier reduces this risk and the possibility of a comment becoming time critical.

9.9 Required accounting

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

- 9.9.1 Where it is concluded that the NHS body has an asset of the property and a liability to pay for it, these should be recorded in its balance sheet. The initial amount recorded for each should be the fair value of the property. Subsequently, the asset should be depreciated over its useful economic life and the liability should be reduced as payments for the property are made. In addition, an imputed finance charge on the liability should be recorded in subsequent years using a property-specific rate. The remainder of the PFI payments (i.e. the full payments, less the capital repayment and the imputed financing charge) should be recorded as an operating cost. If the NHS body has any other obligations in relation to the PFI contract, these should be accounted for in accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets'.
- 9.9.2 Generally, the NHS body should recognise each property when it comes into use. An exception is where the purchaser bears significant construction risk, in which case it should recognise the property as it is constructed.
- 9.9.3 The following table sets out the accounting transactions for an on balance sheet PFI project.

Initial Amount

Dr Assets Cr Liabilities	Capitalisation of lease at Fair Value, i.e. Net Present Value (NPV) of minimum lease payments discounted at the rate implicit in the lease.
Asset	Fixed Asset depreciated over useful economic life
Liabilities	Long Term Creditor reduced by capital element of rental payment

Subsequent Transactions

Balance Sheet	May need to increase creditor if finance charge is greater than rental payments
Operating Cost Statement	(a) Depreciation charge to Operating Cost Statement (b) Total rental payment less finance charge = operating cost to Operating Cost Statement (interest element) (c) Finance charge to PFI Creditor, (capital element - see Chapter 6) (d) Service element of finance lease

Off Balance Sheet: Operator (PFI Partner) has an asset of the property

- 9.9.4 Where it is concluded that the NHS body does not have an asset of the property, they will simply record the cash payments to the contractor within their Operating Cost Statement. There may nevertheless be other assets or liabilities that require recognition. These can arise in respect of the acquisition of the **residual interests** and other obligations of the purchaser and in respect of **contributions**

9.10 Residual Interests

- 9.10.1 In some PFI transactions, all or part of the property (e.g. the land element) will pass to the NHS body at the end of the contract. Where the contract specifies that this transaction should take place at market value at the date of transfer, no accounting is required until the date of transfer, as this represents future capital expenditure for the body.
- 9.10.2 Where the contract specifies the amount (including zero) at which the property will be transferred to the NHS body at the end of the contract, the specified amount will not necessarily correspond with the expected fair value of the residual estimated at the start of the contract. Any difference must be built up over the life of the contract in order to ensure a proper allocation of payments made between the cost of services under the contract and the acquisition of the residual. At the end of the contract the accumulated balance (whether positive or negative), together with any final payment, should exactly match the originally estimated fair value of the residual. For example, if the expected residual value at the end of a 30-year contract is £20 million, but the contract specifies that £30 million should be paid by the purchaser for that residual at that date, then a credit balance of £10 million should be accrued over the life of the contract, with the corresponding charge each year being included in the service expense. The payment of £30 million at the end of the contract will extinguish the balance

of £10 million and establish an asset of £20 million, representing the value of the residual.

- 9.10.3 If, during the life of the contract, expectations change so that the expected value of the residual falls (but there are no changes to the payments scheduled under the contract), then consideration should be given to whether there has been an impairment. Ultimately, a positive difference may become negative, in which case a provision is required. Using the example above, if the expected residual value fell to zero after five years, then an expense and liability of £20 million would be recorded immediately. The remaining £10 million is still accrued over the life of the contract, giving a final liability of £30 million which is paid at the end of the contract.
- 9.10.4 It should be noted that an asset thus created falls to be included in the calculation of relevant net assets and so impacts on capital charges.

9.11 Contribution of existing assets – debtor (prepayment)

- 9.11.1 Contributions to a PFI 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 whether they give rise to future benefits for the purchaser. For example:

- If the contribution of an existing property results in lower service payments, the carrying amount of the property should be reclassified as a debtor (prepayment) in current assets and subsequently charged as an operating cost over the period of reduced PFI payments. The asset is valued at the NPV of the future stream of service payments savings. If there is in effect a sale of part of the contributed asset (for example, a parcel of surplus land that is not used in the PFI contract), any profit/loss should be recognised.
- If the contribution does not give rise to a future benefit for the purchaser, it should be charged as an expense when the contribution is made. For example, a capital grant might be given for which the operator would have qualified even if the transaction had not been part of the PFI, or short life assets might be donated to the contract for no value. Disposal of a capital asset in this way will result in a loss on disposal of assets as a charge to the Operating Cost Statement, as the asset is disposed of for no consideration.

9.12 Disclosure requirements

- 9.12.1 The disclosure requirements for a lessee under a PFI contract are set out in SSAP 21: Leases and the Purchase Contracts. However to take account of the long term nature of most PFI contracts, the following additional disclosures are required for off balance sheet transactions and the 'services' element of any on balance sheet transactions:
- The total amount charged as an expense in the Operating Cost Statement in respect of PFI transactions;

- The payments which it is committed to make during the next year analysed between those in which the commitment expires:
 - within one year
 - in the 2nd to 5th year inclusive
 - in the 6th to 10th year inclusive
 - and so on in five year bandings

9.12.2 Since the annual payments under PFI 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.

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

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

9.12.4 The disclosure requirements of paragraph 30 of FRS 5: Reporting the Substance of Transactions is also relevant to PFI transactions. This requires that:

- the disclosure of a transaction in the financial statements; whether or not it has resulted in assets or liabilities being recognised or ceasing to be recognised, should be sufficient to enable the user of the financial statements to understand its commercial effect; and
- where a transaction has resulted in the recognition of assets or liabilities whose nature differs from that of items usually included in the relevant balance sheet heading, the differences should be explained.

9.12.6 Therefore, 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.

9.12.6 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.

9.13 Re-financing

- 9.13.1 Following the Code of Conduct for the Refinancing of PFI transactions there may be a need to account for changes to the original financing element of PFI assets. This is likely to result in a different finance charge element according to the revised financial structure of the contract.
- 9.13.2 The change in the financing 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.
- 9.13.3 The resultant difference in the finance charges should be accrued over the remaining life of the PFI contract. This will result in different amounts being charged to the Operating Cost Statement each year than those arising from the original contract. 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.
- 9.13.4 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 since it is judged on the expenditure against the RRL and will be funded for its resultant cash requirement.

9.14 Future developments

- 9.14.1 Early in 2005, CIPFA reported that 'There is no international equivalent to FRS 5. However, as part of its project on service concessions IFRIC (International Financial Reporting Interpretations Committee) will shortly issue three draft interpretations addressing accounting for PFI style arrangements. These interpretations are likely to focus on the operator rather than the grantor of the concession and rely on the concept of control rather than the risk and rewards approach, which underpins FRS 5. They appear to assume that in all but a highly limited number of cases physical assets used in service concession arrangements will be recognised on the balance sheet of the grantor rather than the operator. In a public sector context this would mean that most physical assets would be recognised on the balance sheet of the public sector body'.
- 9.14.2 It is not absolutely clear yet how the IFRIC Interpretation will affect the public sector. HM Treasury are currently considering the implications of the Interpretation as part of a possible revision of their Technical Note 1 (How to Account for PFI Transactions). The Interpretation indicates the potential direction of future accounting treatment. The Financial Reporting Advisory Board has indicated that it is likely to provide a strong indication of the possible future accounting treatment impact on the public sector if adopted by the ASB into UK GAAP.

Appendix I – Quantitative Risk Indicators

Indications that the property is an asset of the purchaser	Indications that the property is an asset of the operator
<p>Demand risk is significant and borne by the purchaser, e.g.</p> <p>(a) the payments between the operator and the purchaser will not reflect usage of the property so that the purchaser will have to pay the operator for the property whether or not it is used</p> <p>(b) the purchaser gains where future demand is greater than expected.</p>	<p>Demand risk is significant and borne by the operator, e.g.</p> <p>(a) the payments between the operator and the purchaser will vary proportionately to reflect usage of the property over all reasonably likely levels of demand, so that the purchaser will not have to pay the operator for the property to the extent it is not used</p> <p>(b) the operator gains where future demand is greater than expected.</p>
<p>There is genuine scope for significant third-party use of the property but the purchaser significantly restricts such use.</p> <p>The purchaser in some way guarantees the operator’s property income.</p>	<p>The property can be used, and paid for, to a significant extent by third parties and such revenues are necessary for the operator to cover its costs.</p> <p>The purchaser does not guarantee the operator’s property income.</p>
<p>The purchaser determines the key features of the property and how it will be operated.</p>	<p>The operator has significant ongoing discretion over what property is to be built and how it will be operated.</p>
<p>Potential penalties for underperformance or non-availability of the property are either not significant or are unlikely to occur.</p>	<p>Potential penalties for underperformance or non-availability of the property are significant and have a reasonable possibility of occurring.</p>
<p>Relevant costs are both significant and highly uncertain, and all potential material cost variations will be passed on to the purchaser.</p>	<p>Relevant costs are both significant and highly uncertain, and all potential material cost variations will be borne by the operator.</p>
<p>Obsolescence or changes in technology are significant, and the purchaser will bear the costs and any associated benefits.</p>	<p>Obsolescence or changes in technology are significant, and the operator will bear the costs and any associated benefits.</p>

<p>Indications that the property is an asset of the purchaser</p>	<p>Indications that the property is an asset of the operator</p>
<p>Residual value risk is significant (the term of the PFI contract is materially less than the useful economic life of the property) and borne by the purchaser.</p>	<p>Residual value risk is significant (the term of the PFI contract is materially less than the useful economic life of the property) and borne by the operator.</p>
<p>The position of the parties to the transaction is consistent with the property being an asset of the purchaser, e.g.</p> <p>(a) the operator's debt funding is such that it implies the contract is in effect a financing arrangement</p> <p>(b) the bank financing would be fully paid out by the purchaser if the contract is terminated under all events of default including operator default.</p>	<p>The position of the parties to the transaction is consistent with the property being an asset of the operator, e.g.</p> <p>(a) the operator's debt funding includes a significant amount of equity</p> <p>(b) the bank financing would be fully paid out by the purchaser only in the event of purchaser default or limited force majeure circumstances.</p>

Appendix II – Qualitative Risk Indicators

Feature	Indications that the property is an asset of the Purchaser	Indications that the asset is an asset of the operator
Termination for operator default	The Application Note says: <i>‘a financing arrangement would be indicated where, in the event that the contract is terminated early, the bank financing will be fully paid out by the purchaser under all events of default, including operator default’.</i>	There is no guarantee that the bank financing will be fully paid out by the purchaser.
Nature of operator's financing	<p><i>‘An assessment of the operator’s financing arrangements (all aspects should be taken into account, e.g. the use of senior or subordinated debt and the presence of any guarantees) may indicate a level of debt funding that could be credible only if another party stood behind the operator’.</i></p> <p>This means that very high levels of gearing are an indicator that insufficient risk has been transferred and that the property is an asset of the purchaser.</p>	The level of equity funding should not be used as an indicator that the property is an asset of the operator, because the operator may require that level of equity to match the service risk it has accepted under the contract. This is therefore a one-sided test.
Who determines the nature of the property	<i>‘The purchaser determines the key features of the property and how it is to be operated, bearing the cost implications of any changes to the method of operation. The purchaser may determine the key features of the property explicitly by agreeing them as terms of the PFI contract or, for example, through a contractual acceptance provision at the end of the construction phase. Alternatively, the purchaser may implicitly determine the key features of the property. For example, a contract for a</i>	<i>‘The operator has significant and ongoing discretion over how to fulfil the PFI contract and makes the key decisions on what property is built and how it is operated, bearing the consequent costs and risks. For example, this would be the case if the operator is free to redesign the property extensively during the term of the contract (perhaps even to scrap the original property and build a replacement), in the hope of reducing its costs. Similarly, in a PFI contract to design, build and operate a</i>

	<p><i>road may specify that the road will revert to the purchaser in a predefined state after a relatively short period: this may have the effect that the operator has little discretion over the standard of road to build in the first instance or how it is maintained subsequently'.</i></p> <p>For the avoidance of doubt: The fact that the key features of the property are recorded in the PFI contract, which is agreed by the purchaser, does not necessarily mean that the purchaser has determined those key features.</p> <p>In practice, prior to service commencement, the operator may be required to demonstrate to the purchaser that the arrangements put in place will meet the output specification. Acceptance of the service by the purchaser (based as far as possible on service commencement based tests), without any 'approval' of the means of delivery of the service will not, in most cases, mean that the purchaser determines the key features of the property.</p>	<p><i>road, the operator may have complete discretion over the balance between the quality of the original road build and the consequent level of maintenance costs'.</i></p> <p>The operator may have the freedom to make design changes during the construction period that, whilst not being necessary to meet the contract requirements, are made in the expectation of reducing (or avoiding an increase in) expected operating and life cycle costs.</p>
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10. Asset Registers

10.1 Introduction

10.1.1 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.

10.1.2 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.

10.2 Minimum data set

10.2.1 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 replacement cost (for buildings this will be current indexed valuation)
- (7) Current depreciated replacement cost

- (8) Cumulative depreciation charged to the end of the previous financial year (including buildings since date of acquisition or revaluation)
- (9) Depreciation charged in year
- (10) Indexation adjustments (both on replacement cost and on accumulated depreciation)
- (11) Revaluation adjustments (following full revaluations)
- (12) Asset enhancements (ie additional expenditure to improve the asset or to extend its useful life)
- (13) Impairments (losses and reversals although these do not need to be separately recorded)
- (14) Assessed life
- (15) Asset classification
- (16) Asset status (ie whether in operational use, or in construction or declared surplus)

10.2.2 This is a **minimum** data set for accounting purposes, and should permit the analysis of the revaluation 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.

10.2.3 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.

10.3 Scope of asset registers

10.3.1 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 on which depreciation is charged and a capital charge made;
- (2) leased capital assets which are depreciated, the capital charges on which will be reduced by the cost of capital of the corresponding creditor;
- (3) donated assets which are depreciated (although met from the donation reserve), but upon 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 of dwellings separately from the buildings element of the dwellings
- (3) different buildings on the same site with: building structure and engineering services shown separately.

10.3.2 The asset register may itemise the different building *elements* in accordance with the various different elements of each building, in line with the categories used by the appointed valuer. For these assets the register may provide for linking the various elements of a single block together. This is not considered essential; however this functionality would assist in the management of information within the register.

10.3.3 The asset register should also be designed so as to allow the allocation or apportionment of capital charges to the appropriate cost centre.

10.4 Tagging

10.4.1 Asset registers should contain information to facilitate the locating and identification of equipment 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.

10.4.2 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.

10.4.3 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.

10.5 Security and integrity

10.5.1 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.

11. References

11.1 Publications

The following publications are referred to in this Manual:

FRS 5 – Reporting the Substance of Transactions	1994 (and subsequent Application Notes), Accounting Standards Board. ASB Publications, PO Box 939, Milton Keynes, MK9 2HT (01908 230344)
FRS 11 – Impairment of Fixed Assets and Goodwill	1998, Accounting Standards Board.
FRS 15 – Tangible Fixed Assets	1998, Accounting Standards Board.
Leases – Implementation of a New Approach - Discussion Paper	1998, Accounting Standards Board.
Financial Reporting Manual (FReM)	http://www.financial-reporting.gov.uk/manual.htm
NHS Annual Accounts Manuals	Issued May 2003, available http://www.show.scot.nhs.uk/sehd/manuals.htm
Royal Institute of Chartered Surveyors (RICS) – Appraisal and Valuation Manual	Royal Institute of Chartered Surveyors www.rics.org.uk
Scottish Capital Investment Manual	Issued 1996. Available from HMSO Books.
SSAP 4 – Accounting for Government Grants	1990, SAC Available from ASB Publications - see above
SSAP 13 – Accounting for Research and Development	1977, SAC
SSAP 21 – Accounting for Leases and Hire Purchase Contracts	1984, SAC
Treasury Technical Note No 1 (Revised)– How to Account for PFI Transactions	1999, HM Treasury, 0171 270 4558/4860/4870 http://www.treasury-projects-taskforce.gov.uk

12. Glossary and Abbreviations***Glossary and abbreviations***

AD	Accumulated Depreciation
ASB	Accounting Standards Board
AUC	Asset(s) under construction
BCIS	Building costs information service
CAM	Capital Accounting Manual
CCE	Capital charge estimates
CRL	Capital Resource Limit
DRC	Depreciated Replacement Cost
EUV	Existing use value
FRAB	Financial Reporting Advisory Board
FRS	Financial Reporting Standard
IFRIC	International Financial Reporting Interpretations Committee
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
RA	Recoverable Amount
R&D	Research and development
RC	Replacement cost
RRL	Revenue Resource Limit
SCIM	Scottish Capital Investment Manual
SHOW	Scottish Health on the Web
SGHD	Scottish Government Health Directorates
SSAP	Statement of Standard Accounting Practice
STRGL	Statement of total recognised gains and losses
UK GAAP	UK generally accepted accounting practice

Appendix

CAPITAL TRANSACTIONS – ACCOUNTING TREATMENT

Case Study

INTRODUCTION

The following scenario relates to a hypothetical project that will enable the modernisation and fundamental redesign of clinical services within a community hospital location. The nature of the cost profile presented in this example is typical of that likely to be incurred by NHS Bodies across the range of projects necessary to support the modernisation of services.

BACKGROUND INFORMATION ON THE SCENARIO

The key strategic drivers for the project are “Delivering for Health” requiring improved local access to an enhanced range of Diagnostic and Treatment services and ‘Ageing with Confidence’ the Elderly strategy requiring the decommissioning of all Long Stay NHS care of the Elderly and the development of a range of suitable alternatives in the Community. Additional factors driving the project include the requirement to rationalise and maximise the use of the existing estate and the extent to which the existing asset meets modern functional suitability requirements eg. dignity, privacy, bed spacing, current statutory standards and the overall physical condition of the property.

Following a detailed option appraisal exercise the project team have selected the preferred option. This will deliver a reconfigured site footprint. Currently the hospital is configured in two blocks A and B. Block A is a category A listed building and houses the Acute ward with X-ray and a limited out patient facility. Block B is currently a Long Stay Elderly ward which is now surplus to requirement. The proposal is for Block A to be upgraded with the existing building converted into an ambulatory care centre with a significantly enhanced range of Diagnostic and Treatment services. The Acute in patient service will be reprovided in a new build extension to Block A with the whole building serviced through a common reception and waiting area at the existing main entrance. Block B is to be demolished and the site cleared for additional car parking, a patient drop off and turning circle next to the main entrance and improved ambulance access.

The nature of the work proposed on the existing building (Block A) will result not only in the replacement of fundamental building and engineering components but also a significant upgrade of these components to the modern standards expected in a new facility. This work will significantly extend the economic useful life of Block A as an asset to support operational service delivery.

Total project cost is estimated as £4.385m. Appendix A provides a more detailed analysis of the individual project cost elements.

The DV assesses the value *of the asset* post completion as £3m.

The existing asset is valued at £1m split between Block A £0.6m and Block B £0.4m.

ACCOUNTING TREATMENT

All of the planned expenditure is essential to bring the facility into operational use and therefore meets the current definition of capital expenditure within FRS15 para 6/7 and the NHS Scotland Capital Accounting manual Para 2.12.1 viz:

'A tangible fixed asset should initially be measured at its cost. Costs, but only those costs, that are directly attributable to bringing the asset into working condition for its intended use should be included in its measurement.'

FRS15 para 10 further confirms that "Directly attributable" costs include the costs of site preparation and clearance and Para 2.12 of the NHS Scotland Capital Accounting manual states that "costs incurred in demolishing or rearranging existing assets should be capitalised where this is necessary to allow a new asset to be built".

With regard to expenditure on the existing Block A, FRS15 para 36 states that 'Subsequent expenditure should be capitalised in three circumstances:

- (a) where the subsequent expenditure provides an enhancement of the economic benefits of the tangible fixed asset in excess of the previously assessed standard of performance**
- (b) where a component of the tangible fixed asset that has been treated separately for depreciation purposes and depreciated over the individual useful economic life, is replaced and restored**
- (c) where the subsequent expenditure relates to a major inspection or overhaul of a tangible fixed asset that restores the economic benefits of the asset that have been consumed by the entity and have already been reflected in depreciation'.**

The planned project spend not only significantly extends the economic useful life of the whole asset (which in its existing state has a very low remaining life) but also addresses the functional constraints and non-compliance with statutory standards eg. dignity and privacy, bed spacing and infection control that would, in the near future, have resulted in the asset being taken out of operation as an effective clinical unit. In its reconfigured form the asset will provide a further 30 years operational effectiveness as a clinical unit.

In light of extant guidance the following accounting treatment will apply:

- The £4.385m project cost is capital expenditure charged against the Capital Resource Limit (CRL).
- The £0.4m loss on demolition of block B will be a charge to the CRL offset by the NBV benefit retained by the NHS body

- The £1.985m impairment on completion of the project (£4.385m project cost less £3m DV assessed asset value on completion plus £0.6m NBV of existing block A) will be a charge to the Operating Cost statement offset by a compensating Treasury funded increase to the Revenue Resource Limit.

CONCLUSION

(a) the determined accounting treatment is consistent with current FRS policy and Treasury Guidance in relation to the capitalisation of expenditure and the impact of demolition and valuation impairment.

(b) The NHS Body would, in practice, be funded for the impairment of £1.985m by a compensating Treasury approved increase to the Revenue Resource Limit.

Appendix A

Cost elements within the overall project cost are analysed as follows: -

1. The premises in their existing state have no internal security arrangements. The project allows for supply and installation of security systems for the whole facility (block A and the new extension) including alarm system and CCTV - £100k. This will ensure an economic useful life (operational effectiveness) of at least 30 years
2. The external lighting is currently inadequate. A condition of planning approval is that additional external security lighting is installed and the existing installations significantly upgraded to improve visibility and coverage across the whole facility - £60k. This will ensure an economic useful life (operational effectiveness) of at least 30 years
3. The existing arrangements require bottled medical gases in the wards. The project allows for supply and installation of piped medical gases - £50k. This will improve overall operating efficiency, reducing operating costs, reducing impact on nurse staffing levels and allowing all patients to utilise medical gases simultaneously as demand dictates and recognising the increasing complex needs of patients cared for in non specialist settings.
4. The existing lift in Block A is reaching the end of its useful life. The project allows for the replacement and upgrade to modern standards of the current lift and associated mechanical workings - £100k. This will ensure an economic useful life (operational effectiveness) of at least 30 years.
5. The project allows for removal of the following Electrical and Mechanical items from the old Block A and replacement with a modern standard installation consistent with that planned for the new build extension. These items have reached the end of their useful life, are assessed as technically incapable of meeting the increased demands of the reconfigured facility and require to be fully integrated with the planned installations in the new build ward extension. This will ensure an economic useful life (operational effectiveness) across the entire facility of at least 30 years.
 - Boiler, heating and hot water system including the boiler mechanism, pumps, radiators and all associated pipe work and controls - £500k
 - Cold water pipe work, sanitary ware and the drainage and sewerage system - £200k
 - The electrical system including all wiring, switch gear and fittings - £800k
6. The existing Block A has no hard wired IT communications. The project allows for supply and installation of modern IT communications for the whole facility (block A and the new extension) including a new main switchboard, category 6 wiring and outlets with associated hardware - £175k. This will ensure continued operational effectiveness for at least 10 years, for example through digital transmission and storing of images, enhanced voice, image and data communication technology eg. Telecare, telemedicine, teledermatology.
7. Block A currently has inadequate insulation. The project allows for supply and installation of insulation for the external walls and timber floors - £150k. This

will improve the operational efficiency of the building with an estimated payback on heating costs of 7 years.

8. Block A fire prevention measures are required to meet standards consistent with current regulations as they apply to the new build extension. This is a condition attached to the building warrant. The project includes the upgrade of all fire doors and other fire prevention measures to appropriate standards eg. compartmentation of floors. This will ensure continued operational use of the building through compliance with modern building standards for 20 years - £200k
9. The existing single glazed windows in block A are at the end of their useful life. The project allows for the removal of the existing single glazed windows and replacing them with custom build "sash and case" double glazed units manufactured to Historic Scotland specifications in order to comply with the listed buildings consent - £500k
10. The project requires the extensive reconfiguration of the internal layout of the building to convert mainly old "dormitory" ward accommodation into modern consulting, examination and treatment facilities. The work involves the supply and fitting of internal walls, partitions and doors and where necessary because of the extensive nature of the work renewal of all internal wall, floor and ceiling finishes. This will increase the economic useful life (operational effectiveness) of the internal structures of the building following the change in use from ward to ambulatory care by at least 30 years - £200k
11. Building and engineering costs of new extension - £700k.
12. Site preparation, demolition of block B and asbestos removal from Block A and B - £400k. These are essential enabling costs and clearly the asset cannot be brought into a "working condition" unless this work is completed.
13. Create new car park, tarmac surfacing - £100k. These are essential enabling costs.
14. The project allows for the supply and installation of external railings (period feature). This was a condition of planning approval and clearly the asset cannot be brought into a "working condition" unless this work is complete - £50k
15. Due to the extensive and disruptive nature of the building and engineering work the project allows for the redecoration and making good after this work is complete. These are essential enabling costs and clearly the asset cannot be brought into a "working condition" unless this work is completed - £100k