Ministry of Defence

JSP 472
Financial Accounting & Reporting Manual

Part 1: Directive

Foreword

I am pleased to present this updated financial accounting and reporting policy direction for 2015-16 prepared by the Accounting and Treasury Management team in Finance Management Policy and Accounting (FMPA).

This JSP sets out the accounting policy that the Department must apply in preparing its Annual Accounts in order to comply with applicable International Financial Reporting Standards (IFRSs) as adapted and interpreted by the HM Treasury's Financial Reporting Manual (FReM).

In addition, this JSP also sets out the Treasury and Parliamentary approval and reporting requirements for Losses, Special Payments and Liabilities.

The JSP is designed to be applied by all practitioners and others engaged in the preparation of resource accounting information, Annual Budget Cycles and in-year financial accounting and reporting. Other users may also find the information a useful reference.

This JSP now incorporates the RAC Usage Notes formerly contained in JSP 530 (which has now been deleted).

This JSP is updated every financial year to reflect changes in policy. The two main accounting policy changes for 2015-16 are the introduction of IFRS 13 – Fair Value Measurement and changes to the format of the published Annual Report and Accounts.

Further clarity on the types and the treatment of losses has been reflected in an updated chapter as a result of the FMPA led losses project.

Changes to the special severance payment approvals process, in line with the revised Cabinet Office guidance, have also been incorporated.

I commend it to you and your staff.

Louise Tulett
DG Finance
Defence Authority for Financial Management and Approvals

Preface

How to use this JSP

1. JSP 472 applicable for financial year 2015-16 explains the accounting policies which must be applied when preparing the Department's financial statements to ensure they comply with the requirements of International Accounting Standards (as interpreted/adapted by HM Treasury in its Financial Reporting Manual (FReM)). It also explains the approval and reporting requirements for losses and special payments and for certain classes of actual and contingent liabilities, as set out in Managing Public Money (MPM).

2. Its main uses are in the preparation of:

a. the Annual Budget Cycles (ABC);

b. in-year financial accounting and reporting information;

c. the Annual Report and Accounts (ARAc);

d. the Whole of Government Accounts (WGA).

3. This JSP is structured in two parts:

a. Part 1 - Directive. This provides direction that must be followed, in accordance with mandated policy.

b. Part 2 - Guidance. This provides the guidance that will assist users in complying with the Directive.

Further Advice and Feedback - Contacts

4. Points of contact for any policy advice on financial accounting; on losses and special payments; or on HM Treasury approval/Parliamentary reporting requirements for certain classes of actual and contingent liabilities are listed in Figure 1 below.

5. Any queries and feedback on this JSP should be directed to the individuals listed in Figure 1 below.

Figure 1

Post and Responsibility	E-mail address	Telephone Number
FMPA A&TM Ahd Acctg Pol & TM (Accounting Policy)	HOCF-FMPA-A&TM-Ahd-ACCTPOL&TM	Int: 967984646 Ext:03067984646
FMPA A&TM Acctg Pol TM&TA (Accounting Policy)	HOCF-FMPA-A&TM-ACCPOL-TM&TA	Int: 9679 84640 Ext:030 679 84640
FMPA A&TM CFAT2 (Losses and Special payments other than Special Severance Payments).	HOCF-FMPA-A&TM-CFAT2	Int: 9679 84636 Ext:030 679 84636
FMPA Ahd Fin Pol Governance (Special Severance Payments).	HOCF-FMPA-Ahd Governance	Int: 9621 86949 Ext:0207 218 6949
FMPA A&TM CFAT1 (Liabilities – HM Treasury and Parliamentary notification requirements only)	HOCF-FMPA-A&TM-CFAT1	Int: 9679 84633 Ext:030 679 84633
FMPA A&TM CFAT3 (RAC usage notes)	HOCF-FMPA-A&TM-CFAT3	Int: 9679 85709 Ext:030 679 85709

Scope

6. This JSP applies to all TLBs and Agencies which fall within Voted expenditure (i.e. it excludes Arms Length Bodies (ALBs).

7. Although Agencies (within Voted expenditure) are given some flexibility to tailor accounting policies to meet their own particular circumstances within their annual report and accounts, they must ensure that the end result is consistent with the policies contained within this JSP.

8. Expenditure on the Armed Forces Pension Scheme (AFPS) and the Armed Forces Compensation Scheme (AFCS) is defence expenditure for which the Accounting Officer is responsible to Parliament, even though it is not included within the Spending Review. Policies for the AFPS and AFCS are covered in this JSP.

General Responsibilities for Financial Management

9. The roles and responsibilities of the Permanent Under Secretary (PUS), Director General Finance (DG Fin) and the Directors' of Resources are detailed in JSP 462 Part 1 Chapters 4 and 5.

Amendments and Updates to this JSP

10. This JSP is 2015-16 Version 1. The content of the JSP will be updated and a new version published at the beginning of each financial year. An amendments log will detail changes which have occurred since the previous version.

11. Where appropriate, amendments will be made the during the year. Changes will be recorded on an in-year amendments log.

Amendment Log

12. The main amendments to the 2014/15 Financial Accounting and Reporting Manual reflected in this 2015/16 version are listed below (as Amendment Version 1). Any amendments arising during 2015/16 and applicable to 2015/16 are listed below as a further amendment with subsequent Version numbers.

Log	Amendment Version	Chapter	Summary of Change	Applicable FY
1	1	1	Reference made to Part 2 Chapter 14 RAC Usage Notes.	2015-16
2	1	1	The Annual Report and Accounts Section has been amended to reflect the new reporting structure of: The Performance Report; The Accountability Report; and The Financial Statements.	2015-16
3	1	4	Following introduction of IFRS 13 – intangible non-current assets should be valued at market value in existing use where an active market exists.	2015-16
4	1	5	The policy for the valuation of tangible non-current assets has been amended following the introduction of IFRS 13.	2015-16
5	1	5	Roles and responsibilities have been updated.	2015-16
6	1	9	Updates to the Armed Forces Pension Scheme Section.	2015-16
7	1	12	Updates to the Policy on Losses and Special Payments.	2015-16

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Log	Amendment Version	Chapter	Summary of Change	Applicable FY
8	1	13	Updates to the Policy on the Parliamentary and HM Treasury Parliamentary reporting requirements for liabilities.	2015-16

Contents

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1 Basis of the Annual Report and Accounts

Introduction

1. This chapter sets out the accounting policies and principles to be applied when preparing the Annual Report and Accounts (ARAc). It also explains the main elements of the Annual Report and Accounts; the Departmental boundary; the consolidation process; and the policy on Inter-Management Grouping (IMG) transfers.

Specific Responsibilities

2. Specific responsibilities are listed below.

Head of Financial Management Policy and Accounting (Hd FMPA)

3. Hd FMPA is responsible for the Annual Accounts and certain sections of the Annual Report.

FMPA Accounting and Treasury Management Team (FMPA A&TM)

4. FMPA A&TM is responsible for:

   a. developing new and/or amending accounting policies;

   b. developing new and/or amending significant estimation techniques.

FMPA Corporate Financial Accounting Team (FMPA CFAT)

5. CFAT is responsible for producing the Department's Group Accounts.

TLBs

6. TLBs are responsible for ensuring that they, their Agencies and the organisations they sponsor (such as Arm's Length Bodies (ALBs)) record and report consistently the information required to produce the Annual Accounts in accordance with the Annual Report and Accounts Instructions and that audit trails are maintained.

Annual Report and Accounting Convention

7. The ARAc is prepared in accordance with the FReM and other instructions issued by HM Treasury and the Cabinet Office.

8. It is expected that the requirements of International Financial Reporting Standards (IFRS) and Parliamentary accountability together with public expenditure control will coincide. However, if there is a conflict the requirements of IFRS will be adapted and interpreted accordingly. HM Treasury's Consolidated Budgeting Guidance states that the Department's ARAc are based on IFRS (as adapted and interpreted by the FReM) but there are a number of differences in how transactions are reflected in budgets. These differences are provided at Annex 3 to the FReM. HMT must be consulted before changing any significant accounting policies and estimation techniques where it appears that there could be a potential impact on budgets and on the National Accounts. HMT should also be consulted when the Department considers it necessary to adjust retrospectively for changes in accounting policies or material errors so the budgetary and Estimates impact can be considered.

Applying Accounting Policies and Principles

9. The ARAc should be prepared using accounting policies which reflect the principles set out in International Accounting Standard (IAS) 8, as well as those set out in the International Accounting Standards Board's (IASB) Framework for the Preparation and Presentation of Financial Statements (known as the Framework). Accounting transactions must be coded correctly in order to account for transactions in accordance with the policies contained in this JSP. To achieve this, Part 2 Chapter 14 contains the guidance on the use of Resource Account Codes (RACs).

10. The objective of providing information about the Department's financial position and performance is to provide Parliamentary Accountability and to give a wide range of stakeholders useful information. Although the Framework does not deal directly with the true and fair view concept, by applying the principles set out in the Framework and selecting the accounting policies prescribed by IAS 8, the financial statements should convey a true and fair view of the accounts.

11. In the absence of an IFRS that specifically applies to a transaction or event, IAS 8 prescribes the following hierarchy of guidance to be used to identify the appropriate accounting policies:

a. requirements of Standards and Interpretations dealing with similar matters;

b. the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework;

c. the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework, provided that they do not conflict with IFRSs and the Framework.

True and Fair View

12. The ARAc are required to give a true and fair view of the financial affairs of reporting entities within the Departmental Boundary.

13. Where, in exceptional circumstances, complying with the requirements of this JSP would be so misleading as to conflict with the objective of financial statements set out in the Framework referred to in Part 2 Chapter 1 paragraph 4, MOD should restrict any departure to the minimum and disclose the following:

a. that management has concluded that the ARAc presents the MOD's financial position, financial performance and cash flows fairly;

b. that the MOD has complied with the FReM, except that it has departed from a particular requirement to achieve a fair presentation;

c. the title of the IFRS (and, if appropriate, adapted or interpreted by the FReM) from which the MOD has departed, the nature of the departure, including the treatment that the FReM would require, the reason why that treatment would be so misleading as to conflict with the objective of financial statements set out in the Framework, and the treatment adopted; and

d. for each period presented, the financial effect of the departure on each item in the ARAc that would have been reported in complying with the requirement.

14. Where the MOD has departed from a requirement of this JSP in a prior period and that departure affects amounts recognised in the ARAc for the current period, the MOD shall make the disclosures set out in Part 1 Chapter 1 paragraphs 13c and 13d.

15. Any proposed material departure can only be made with the agreement of FMPA A&TM who will consult HM Treasury.

Materiality

16. The concept of materiality derives from the premise that although the ARAc need not be spuriously accurate, this does not override the requirement for the accounts to present a true and fair view.

17. An item is regarded as being material if its omission, non-disclosure or misstatement could be expected to distort the view given by the ARAc to a user. There is no formula for determining what is material.

18. TLBs must ensure that their policy on materiality is clearly documented to allow subsequent audit review. Principal factors to be taken into account are:

a. the item's size is judged in the context of the financial statements as a whole and also the other information available to users that would affect their evaluation of the financial statements. This includes, for example, considering how the item affects the evaluation of trends;

b. the item's nature in relation to:

i. the transaction or other events giving rise to it;

ii. the legality, sensitivity, normality and potential consequences of the event or transaction;

iii. the identity of the parties involved; and

iv. the particular headings and disclosures that are affected.

19. The process of preparing accounts gives rise to two types of materiality judgements:

a. whether an item needs to be disclosed;

b. the margin of error, if any, that is acceptable in the amount attributed to an item.

20. Overall Departmental materiality judgements will depend on the nature and relative importance of the amounts involved. The following factors will be relevant:

a. the inherent approximation. Some figures used for the accounts will be estimated. Their lack of precision may be a factor when considering materiality;

b. whether there is excessive precision. Detailed disclosure of immaterial items can serve to obscure the more important messages in the accounts and should be avoided unless the item is specifically required;

c. the amount offset and aggregation. This is the effect of offsetting two or more items which would be material if considered separately.

Key Concepts

21. The International Accounting Standard's Board (IASB) Conceptual Framework ('the Framework') identifies two concepts as playing a pervasive role in financial statements and hence in the selection of accounting policies. Further details are given in Part 2 Chapter 1 paragraphs 4 to 18.

Prior Period Adjustments

22. Prior period adjustments are material adjustments applicable to prior periods which arise from changes in accounting policies or from the correction of material errors. Before any prior period adjustments are made, FMPA A&TM must be consulted as HM Treasury agreement will be required.

23. Material errors are those which could individually or collectively influence the economic decisions of users.

24. Prior period adjustments exclude normal recurring adjustments and corrections of accounting estimates made in prior periods.

25. Prior period adjustments should be accounted for by restating the comparative figures for the preceding period in the primary financial statements (excluding the Statement of Parliamentary Supply); the notes; and the opening balance of reserves for the cumulative effect. In addition, the cumulative effect of the adjustments should be shown in the Statement of Changes in Taxpayers' Equity.

26. In the Statement of Parliamentary Supply, prior period adjustments are treated as current year income or expenditure for the purpose of Parliamentary control. This entails including the adjustment as an item in the reconciliation between 'net operating cost' and 'net resource outturn' via the note in the ARAc (when the adjustment affects the SOCNE and the SOFP).

27. The adjustment should also be disclosed in the Statement of Parliamentary Supply by including an explanation in the variation box. The explanation should briefly cover the reason for the prior period adjustment, referring as necessary to other notes for details of adjustments and any further explanation. Other notes will, as necessary, include additional line items captioned 'Prior Period Adjustment'. The notes should refer to any impact on the Statement of Parliamentary Supply and to the other primary statements.

28. Where practicable, the effect of prior period adjustments on the results of the preceding period should be disclosed.

Annual Report and Accounts

29. The published ARAc is available on the Department's intranet. The ARAc should be laid in accordance with the timetable issued by the Treasury.

30. The ARAc comprises: The Performance Report; The Accountability Report; and The Financial Statements.

31. The purpose of The Performance Report is to provide information on the Department, its main objectives and strategies and the principal risks that it faces. It must provide a fair, balanced and understandable analysis of the Department's performance. It has two sections, an 'Overview' and a 'Performance analysis'.

32. The purpose of The Accountability Report is to meet the key accountability requirements to Parliament. It should include The Corporate Governance Report which contains The Directors' Report, The Statement of Accounting Officer's Responsibilities and The Governance Statement. The Accountability Report must also contain: a Remuneration and Staff Report; and a Parliamentary Accountability and Audit Report.

33. The Financial Statements comprising a SOCNE, SOFP, Statement of Changes in Taxpayers' Equity and the Statement of Cash Flows together with the relevant notes.

34. Full details of the disclosures outlined in Part 1 Chapter 1 paragraphs 30 to 33 are contained in the FReM Chapter 5.

Segmental Reporting

35. The Department is required to disclose information to enable users of its ARAc to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

36. The Department should disclose reporting segments in the ARAc based on the information that the Defence Board uses to make decisions about operating matters and resource allocation.

Disclosure of Administration and Programme Costs

37. The Department should split its SOCNE into Administration and Programme Costs – see Part 1 Chapter 3 paragraph 4. Disclosure should be made in the ARAc on the basis of the split agreed between the Department and HM Treasury.

Subsidiaries, Associated Undertakings and Joint Ventures – The Departmental Boundary

38. The Department's consolidated ARAc cover all entities within the Departmental boundary. The Departmental boundary is similar to the concept of a group under IFRS but is based on control criteria used by the Office for National Statistics (ONS) to determine the sector classification of the relevant Departmental sponsored bodies. Except where legislation requires otherwise, the Department should account for subsidiary undertakings, associate undertakings or joint ventures in accordance with the Group Accounting Standards only if they are designated for consolidation by order of HMT under statutory instrument, which will reflect the ONS's classification of an entity to the central government sector. Executive non-departmental and similar public bodies classified to central government by the ONS will normally be controlled for accountability purposes by only one department and the designation order will require that they are consolidated by the Department. The Group Accounting Standards are IFRS 3, IFRS 10, IFRS 11, IFRS12, IAS 27 and IAS 28.

39. The following entities are outside the Departmental boundary:

a. any body classified as a public corporation by the ONS (which includes most Trading Funds);

b. any body classified to the local government sector by the ONS;

c. non-public funds (such as service messes, sports associations);

d. any body classified to the private sector or to the rest of the world sectors by the ONS.

40. The Departmental resource accounting boundary will, therefore, include the following entities:

a. Supply-financed agencies;

b. non-agency parts of the department accounted for through the Supply process and other bodies whose expenditure is accounted for in separate financial statements, including non-executive NDPBs such as Advisory NDPBs and Tribunal NDPBs;

c. executive NDPBs or other public bodies that produce their own financial statements and which are classified by the ONS to the central government sector

41. Where the Department has an investment in another public sector entity that does not meet the criteria for consolidation in Part 1 Chapter 1 paragraph 38, the investment should be reported following the requirements of IAS39 financial instruments (see Part 1 Chapter 10). This includes all interests in bodies classified as public corporations by the ONS.

42. Where the Department has an investment in another entity that is not classified to the Public Sector but which does satisfy the criteria for consolidation as an associate or joint venture, it should be reported in accordance with IFRS 11, IFRS 12 and IAS 28.

43. Accounting policy relating to other financial assets held by the Department is governed by IAS 32, IAS 39 and IFRS 7 (the financial instruments standards). These are covered in Part 1 Chapter 10.

Business Combinations and Mergers

44. The merger of two or more departments into one new department, or the transfer of functions from the responsibility of one part of the public sector to another, is accounted for as either a Transfer by Merger or a Transfer by Absorption. This requirement is an adaptation to IFRS 3 (Business Combinations) which excludes businesses under common control from its scope (and therefore does not prescribe the accounting for group re-organisations). Public sector bodies are deemed to be under common control.

45. For the purposes of this JSP, a function is defined as an identifiable business operation with an integrated set of activities, staff and recognised assets and/or liabilities that are capable of being conducted and managed to achieve the objectives of that business operation.

46. The accounting treatment for transfers of function under common control should be determined by aligning the reporting with the accountability for financial performance. The underlying objective is to ensure the financial reporting supports the accountability for the transferring function, and to do so in a symmetrical way to ensure there is no transparency gap. A transfer may require both treatments at different levels. Both the transferor and the transferee of a business combination under common control should apply a symmetrical accounting treatment for the transfer. A reporting entity that transfers functions to another

reporting entity should also provide the same information about the transfer in its financial statements.

Transfer by Merger

47. Transfer by Merger accounting should be applied at the group level for bodies applying this JSP. This covers transfers of function between the Department and other departments within central government, but not between the Department and the Welsh Government, Northern Ireland Assembly or Scottish Government, whose income and expenditure is controlled directly by Parliamentary Supply processes (departmental group accounts).

48. A Transfer by Merger should be accounted for as follows:

a. the carrying amount of assets and liabilities should not be adjusted to fair value on consolidation, although appropriate adjustments should be made in the accounts of the entity receiving the transfer to achieve uniformity of accounting policies. The net effect of any adjustments should be shown as a movement on reserves and no goodwill should be recognised in the acquiring party's accounts;

b. the results and cash flows of all combining entities should be brought into account from the start of the financial year in which the combination occurs. Restatement of prior-year comparative figures is also required;

c. the entity receiving the transfer should disclose that a transfer has taken place (including a brief description of the transferred function), the date of transfer, and which body(ies) were responsible for the activity prior to transfer, and (if material) should disclose in a note to the accounts the effect on its main financial statements;

d. the entity transferring the assets and liabilities will account in a similar way. This means disclosing that a transfer has taken place, writing off assets and liabilities from the start of the financial year in which the combination occurs, making corresponding adjustments to reserves rather than the SOCNE, restating prior-year comparators, and (if material) disclosing the effect of the transfer on its main financial statements.

49. The effect of this accounting treatment is that central government bodies do not show profits or losses when a Transfer by Merger is applied.

50. Accounting for a Transfer by Mergers may, in some cases, cause differences between the totals in the Statement of Parliamentary Supply and the SOCNE. Such differences should be reconciled in a relevant note to the accounts. In addition, extra entries may be required in the Statement of Cash Flows.

Transfer by Absorption

51. All other transfers of function between public sector bodies should be accounted for

as Transfers by Absorption. This includes transfers to or from Local Government; to or from Public Corporations; between Devolved Administrations and Whitehall Departments; within the Departmental boundary; and for all transfers reported by Executive NDPBs, other arm's length bodies within central government and trading funds.

52. A Transfer by Absorption should be accounted for as follows:

a. the carrying value of the assets and liabilities of the combining bodies or functions are not adjusted to fair value on consolidation;

b. there should be no recognition of goodwill and no restatement of comparatives in the primary financial statements;

c. the recorded amounts of net assets should be brought into the financial statements of the transferee from the date of transfer;

d. the net asset/liability carrying value should be recorded as a non-operating gain/loss from the transfer of function, through net expenditure, with the transferor recording symmetrical entries;

e. revaluation reserves should be transferred in full, with the remaining balance transferred to the General Fund;

f. the entity receiving the transfer of function should disclose that a transfer has taken place (including a brief description of the transferred function), the date of transfer, and which body(ies) were responsible for the activity prior to transfer, and (if material) should disclose in a note to the accounts the effect on its main financial statements. Disclosure of the historical financial performance of the function should also be provided to enable users to understand the operational performance.

53. For all adjustments required to achieve uniformity of accounting policies, the double entry will be to the General Fund.

Consolidation

54. Consolidation involves aggregating data submitted by TLBs, including ALBs within the Departmental boundary, to produce the Annual Accounts, enabling the Department to present its financial information as a single economic entity. For the purposes of applying the principles of consolidation, the Department will be the parent entity in departmental consolidations.

55. Period-end balances with Trading Fund Agencies and Departmental Entities, which fall outside the Departmental boundary, should also be agreed as part of the consolidation process. Financial instructions that must be followed are issued by FMPA each year detailing the tables and schedules required to be completed and other Annual Accounts related issues such as the Letter of Representation, commentaries and audit files. Further details on the consolidation methodology is given in Part 2 Chapter 1 paragraphs 19 to 27.

Inter-Management Grouping (IMG) Transfers

56. For IMG transfers, both parties must agree the transaction. Further details are given in Part 2 Chapter 1 paragraphs 28 to 31.

Retention of Accounting Records

57. Accounting records relating to the preparation of the ARAc, including Agency accounts, must be retained by the appropriate TLB for a minimum of seven years and are subject to audit during this time. The requirement applies to all forms of accounting information, regardless of how it is recorded or stored.

Audit Trail

58. Adequate audit trails must be kept to provide evidence to support the balances and transactions that are reported in the Annual Accounts. Where judgements have been made, the rationale for these judgements must be documented.

59. What constitutes an adequate audit trail is determined by what is required to support the accounting transaction to an auditable standard. Key elements are:

a. evidence of proper authorisation of the payment documentation;

b. evidence of what has been purchased or accrued;

c. evidence of the proper authorisation of the accounting transaction, to include:

i. segregation of duties where the expectation is that the reviewer of the accounting transaction is senior in grade to the preparer of the accounting transaction;

ii. clear signatures and date stamps;

iii. compliance with policy such as minimum accrual thresholds;

d. accessibility – Financial audit trails must be retained for a period of seven years.

Guidance

60. Part 2 Chapter 1 sets out the illustrative Primary Statements, the extant IFRS with their adaptations and interpretations, key accounting concepts, the consolidation methodology and the process for IMG transfers. RAC usage notes guidance is given in Part 2 Chapter 14.

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2 Income

Introduction

1. This chapter sets out the accounting requirements for income.

Recognition

2. Income represents a gross inflow of economic benefits during the period which result in an increase in Taxpayers' Equity. It is recognised only when it is probable that the economic benefits associated with the transaction will flow to the Department. Amounts collected on behalf of third parties such as value added tax do not increase Taxpayers' Equity and should be excluded from revenue. Similarly, where the Department acts an as agent, the amounts collected of behalf of another party are not treated as income.

3. Parliamentary Supply should not be accounted for as income but as financing through the General Fund. The Parliamentary process and accounting arrangements determine how income is presented and is set out in Part 1 Chapter 2 paragraphs 4 to 7.

4. Operating income is any income generated by the Department in pursuit of its activities (generally fees and charges) or as part of managing its affairs (for example, rents, interest and dividends receivable).

5. Proceeds from the sale of investments and Non-Current Assets (NCAs) should be accounted for as non-operating income.

6. Other non-retainable income includes any income or recovery of expenditure that is non-budget (Consolidated Fund Extra Receipts (CFERs)). It should be recorded in the SOCNE. The proceeds of realisations of confiscated, seized and forfeited property go to the Consolidated Fund and are not for the benefit of the Department. Hence, these assets should not be recognised in the financial statements. Any proceeds derived from realising them should be disclosed in a note to the Annual Accounts.

7. Items of income that the Department is authorised to net off gross expenditure in the Statement of Parliamentary Supply for the purpose of Parliamentary control, which relate to any recovery of expenditure recorded in the SOCNE or to returns on investments, should appear in the SOCNE.

8. Income is recognised only when it is probable that the economic benefits associated with the transaction will flow to the Department. In some cases, this may not be probable until the cash is received or until an uncertainty is removed. However, when any uncertainty arises over the recoverability of an amount already included within income or it becomes unlikely that it will be recovered, the amount in question is recognised as an expense, rather than as an adjustment to the amount of income originally recognised. See provision for bad debts (Part 1 Chapter 10 paragraph 45).

9. In accordance with IAS 18, the recognition of income is usually applied separately to each transaction. However, it may be necessary to apply recognition criteria to the separately identifiable components of a single transaction in order to reflect its substance. For example, when the selling price of equipment includes an identifiable amount for subsequent maintenance, that amount is deferred and recognised as revenue over the period during which the service is performed. Conversely, two or more transactions should be dealt with together as one transaction when they are linked. For example, the sale of equipment and, at the same time, a separate contractual agreement to repurchase the equipment at a later date. The substance of this arrangement may be that no sale has taken place.

10. Further details are given on when revenue should be recognised in the sale of goods/equipment and the provision of services in Part 2 Chapter 2 paragraphs 2 to 10.

Measurement

11. Income should be measured at the fair value of the consideration received or receivable, including the deduction of any discounts and volume rebates. Further details are given in Part 2 Chapter 2 paragraphs 11 and 12.

Specific Accounting Requirements

Donated Assets

12. Donated assets are those which have been donated to the Department. Assets can be donated by a third party either by gifting the assets or gifting funds with which to purchase the assets.

13. To qualify as a donated asset, there should be no consideration given in return. However, donated assets do not include:

a. assets financed by grant-in-aid;

b. the subsequent expenditure on a donated asset which is capitalised (see Part 1 Chapter 2 paragraph 21);

c. assets constructed or contributed to by a developer to benefit the developer's business (i.e. the situation where the developer builds or enhances an asset (for example, when involved in the provision of a service to the public sector) but the public sector gains no direct economic benefit, as the primary purpose of the building/enhancement is to enable the developer to better perform the function;

d. assets accepted in lieu of tax.

14. Assets that do not pass this test should be accounted for in the same way as any other NCA. See Part 1 Chapter 5.

15. Where a donor imposes restrictions or conditions on the use of a donated asset, details of the restrictions or conditions should be disclosed in a note to the accounts.

16. The Department may give or receive assets to/from another public sector body (including public sector bodies outside the Departmental boundary) for no consideration. Assets acquired in this way are not donated assets. The transfer of NCAs to another government department under a transfer of function, or a merger of departments, should be treated as a normal commercial transaction i.e. as a sale at fair value. If assets are to be transferred for no consideration, FMPA A&TM should be consulted before entering into such an arrangement as the proposal will need to be discussed with HM Treasury.

17. Donated assets are capitalised at their fair value on receipt. Where the value of the services provided by an asset will be less than the asset's fair value because it is over specified for its intended use, the lower value should be used. The funding element should be recognised as income in the SOCNE. This income should be deferred only if a condition imposed by the funder represents a requirement for the future economic benefits embodied in the donation to be consumed as specified by the donor (or if not, to be returned) - for example, the donation is conditional on the construction of an asset.

18. A contribution or donated asset may be received subject to a condition that it be returned to the donor if a specified future event does or does not occur (for example, a donation may need to be returned if the Department ceases to use the asset purchased with the donation for the purpose specified by the donor). In such cases, a return obligation does not arise until such time as it is expected that the condition will be breached, at which point the liability is first recognised. Such conditions do not prevent the contribution or the donated asset from being recognised as income in the SOCNE.

19. Donated assets should be recorded under an appropriate category within the SOFP and within the NCAR.

20. Donated assets are revalued, depreciated and impaired on the same basis as other NCAs. See part 1 Chapter 5.

21. Subsequent expenditure on donated assets must be captured separately if the expenditure is capital in nature. Capital expenditure in this category must not be treated as donated but should be accounted for in the same way as enhancements to other Departmental assets (see Part 1 Chapter 5 paragraph 69). The enhancement will be separately recorded in the NCAR.

22. Donated assets which are classified as held for sale should be removed from the NCAR and re-valued to the lower of their carrying amount and their fair value less costs to sell. Any decline in value down to depreciated historic cost should be taken through the Revaluation Reserve. Any decline in value below depreciated historic cost should be charged to the net operating cost section of the SOCNE. The subsequent disposal is accounted for in the same manner as other NCAs (see Part 1 Chapter 5 paragraph 135).

Assets Funded by Grants

23. Grants received can come from government and inter-governmental agencies and similar bodies, whether local, national or international, including the European Union (EU).

24. The NCAs purchased with the granted funds (which may finance the asset purchase in whole or in part) should be capitalised at full cost and reported within the SOFP under an appropriate NCA category. They should also be recorded on the NCAR. The funding element should be recognised as income in the SOCNE. This income should be deferred only if a condition imposed by the funder represents a requirement that the future economic benefits embodied in the grant are consumed as specified by the grantor or must be returned to them - for example, the grant is conditional on the construction of an asset.

25. A grant may be received subject to a condition that it be returned to the donor if a specified future event does or does not occur (for example, a grant may need to be returned if the Department ceases to use the asset purchased with the grant for a purpose specified by the grantor). In these cases, a return obligation does not arise until such time as it is expected that the condition will be breached and a liability is not recognised until that time. Such conditions do not prevent the grant from being recognised as income.

26. Assets financed in whole or in part by a grant should be revalued, depreciated and impaired in the same way as other NCAs. See Part 1 Chapter 5.

27. Subsequent expenditure on grant funded assets that is not financed by grant should be treated in the same way as subsequent expenditure incurred on donated assets. In addition, disposals of grant funded assets should be treated in the same manner as donated assets. See Part 1 Chapter 2 paragraphs 21 and 22.

28. The notes to the accounts should distinguish between UK grants and EU grants.

Contingent Assets

29. Contingent assets represent a possible inflow of future economic benefits, where the inflow is dependent on an uncertain future event taking place. If the inflow is virtually certain, the income/asset should be accrued. If it is only probable, it should be disclosed in a note to the accounts. If it is not probable, no disclosure is required.

30. Where a contingent asset is disclosed, this should include a brief description of the nature of the contingent asset at the reporting period date. It should be measured in the same way as a provision for liabilities and charges. See Part 1 Chapter 8.

Guidance

31. Part 2 Chapter 2 provides further details on when revenue should be recognised and measured.

3 Expenditure

Introduction

1. This chapter sets out the accounting requirements for expenditure. Details on accounting for the Department's foreign currency forward contracts are contained in Part 1 Chapter 10.

Specific Responsibilities

2. Specific responsibilities are listed below.

FMPA Accounting and Treasury Management Team (FMPA A&TM)

3. The FMPA A&TM is responsible for:

a. the 'Offset Banking Group Scheme accounts overseas' (currently available for Germany, Italy, USA and Gibraltar);

b. the forward purchase foreign currency contracts (currently US $ and Euros);

c. the funding of Government Banking Service (GBS) accounts;

d. the monthly calculation and promulgation of General Accounting Rates (GARs) for foreign currency translation;

e. promulgating a Forces Fixed Rate (FFR) for foreign currency exchange payments made to UK based personnel on permanent posting overseas (the FFR is calculated by Defence Business Services (DBS) Military Personnel);

f. promulgating on the Finance Hub the period end mid-market closing rates for use in the Annual Report and Accounts (ARAc).

g. Accounting for the forward purchase foreign currency contract derivatives and fuel hedging contract derivatives.

Disclosure of Administration and Programme Costs

4. The Department should split its SOCNE into Administration and Programme Costsin the Annual Accounts.

5. Defence Resources are responsible for what constitutes Administration costs and what constitutes Programme costs.

Construction Contracts

6. Construction contract balances relate to commercial work undertaken on behalf of external customers and cover costs incurred on all production/repair and associated tasks.

7. The costs are recognised in the SOFP until the associated work is invoiced, at which point the invoiced amounts will be included in operating income. An appropriate amount is then released from the construction contract balance to the SOCNE and matched against the related income.

8. The period end construction contract balance should be reported as a receivable and should reflect the contract cost balance less any provision for contract losses.

9. As construction contracts balances are reported as receivables, they are not re-valued.

10. Amounts recoverable (i.e. receivable but not invoiced) on other long-term contracts not falling within the definition of construction contracts (for example, provision of training to external customers) are accounted for as income in accordance with Part 1 Chapter 2.

11. Incomplete work relating to other tasks and services provided (for example, training for repayment customers) does not fall within the scope of IAS 11, ‘Construction contracts’. It is accounted for in accordance with Part 1 Chapter 2.

12. Any costs incurred which will be capitalised on completion in the Department’s SOFP, i.e. in relation to NCAs (including capital spares and GWMB) for the Department’s own use rather than for an external customer, are accounted for as AUC.

Reporting Foreign Currency Transactions

13. Although the ARAc are published in sterling, the Department undertakes many foreign currency transactions. It also holds some financial assets and liabilities that are denominated in currencies other than sterling.

14. Under IAS 21, foreign operations are required to measure results in their functional currency, i.e. the currency of the primary economic environment in which they operate. As the Department’s functional currency is sterling, the ARAc are presented in sterling.

15. IAS 21 also states that if the activities of the foreign operation are carried out as an extension of the reporting entity, the functional currency of the foreign operation will be the same as that of the reporting entity. As the activities of the foreign operations are carried out as an extension of the Department’s activities, the functional currency of those operations will always be £ sterling.

16. Occasionally the exchange rate changes between the date of the transaction and the date of payment, giving rise to:

a. settled transactions: where transactions are settled at an exchange rate that differs from the rate used when the transactions were recorded – typically when a payment is made in the month after the purchase is recorded;

b. unsettled transactions: where the exchange rate at the reporting period date differs from the rates at which transactions were recorded in the accounts – typically at the year end and 'hard close' period ends (APs 9 and 12) when currencies are translated from the GAR to the mid-market rate.

17. The Department enters into foreign currency forward contracts to buy US $ and Euros. Forward contract commitments are based on TLBs' planned future expenditure requirements which are identified in their Annual Budget Cycles submissions.

18. In accordance with financial instrument accounting requirements, the fair value of the Department's forward contracts should be recognised as a financial asset or a financial liability in its Statement of Financial Position (SOFP).

19. Forward contracts should be valued quarterly and again immediately prior to settlement. Any differences between the actual cost of the forward contract and the spot rate on the day of delivery will have been charged/credited to the SOCNE on valuation. See Part 2 Chapter 10 for further details.

20. All exchange differences, whether arising on settled or unsettled transactions, should be charged/credited to the SOCNE.

Initial Recognition

21. Assets, liabilities, expenditure or income arising from transactions which are denominated in a foreign currency should be translated into sterling at the exchange rate prevailing at the transaction date.

22. For this purpose, the 'transaction date' is defined as the date on which the transaction is recognised in the accounting records under the accounting rules described in this JSP.

23. The exchange rate prevailing at the transaction date (i.e. the spot rate) should be used on initial recognition. However, for practical reasons, IAS 21 permits an average monthly conversion rate to be used where exchange rates do not fluctuate significantly during the month. As a result, the Department can use a single representative rate as the GAR for translating its foreign currency transactions into sterling.

24. The GAR should be issued at the beginning of each month to represent the forecast monthly average spot rate for a particular currency. The NAO has approved the use of a monthly spot rate on materiality grounds.

25. The spot rates should be based on the published market rates.

26. The monthly GARs for the major currencies used (i.e. US $ and Euros) should be based on either the Financial Times (FT) or Bank of England (BoE) published spot rates in the week immediately preceding the new month. For all other currencies the rate published by either the FT, BoE or suitable source for minor currencies on the last Friday before the month end should be used.

27. The FFR is the exchange rate used to convert sterling denominated pay and allowances of Service Personnel and UK Based Civilians serving overseas into local currency values. Its purpose is to ensure that personnel serving overseas are not penalised as a result of excessive exchange rate fluctuations. The difference between the sterling values of the pay/allowance and the subsequent sterling value charged back at the FFR or GAR is posted to the exchange gain/loss range of RACs.

28. The GAR and FFR rates should be published on a monthly basis by FMPA A&TM. The year-end closing mid-market rates are published by FMPA A&TM on the first working day after 1 April. Rates are promulgated to TLBs and they are also posted on the Defence Intranet.

29. The exchange rates applied in translating a foreign currency denominated transaction are summarised in Figure 1 below:

Figure 1

Spot & Forward Rates	The actual rates obtained by FMPA A&TM for purchase of currency.
Closing Mid-Market Rate	The rate at which monetary assets and liabilities at the financial year end and 'hard close' period ends denominated in foreign currency are revalued in sterling for the ARAc. The year end rates are the FT published mid market closing rates for 31 March or the nearest working day before.
GAR	The rate at which all receipts/expenditure in foreign currencies are translated. Rates are based on the forecast average spot rate for the month and are notified monthly. Other than at the year end and 'hard close' period ends, monetary assets and liabilities are translated at the GAR.
FFR	The rate of exchange at which sterling denominated pay and allowances of UK Based Civilians and Service Personnel serving overseas are translated and paid in local currency.

Accounting for Exchange Differences

30. Exchange differences arise in the following circumstances:

a. where a currency transaction is settled at an exchange rate (see above) which differs from the rate used when the transaction was initially recorded;

b. where the rate of exchange used for unsettled transactions at the reporting period date differs from that used previously;

c. when an asset denominated in foreign currency is converted to sterling at the latest GAR/year-end rates;

d. when there is a foreign currency requirement for a currency not covered by the Offset Banking Group Scheme and DBS makes a spot purchase. The cost of the currency at the GAR and any difference between the Spot Rate and the GAR is charged to the TLB requesting the currency using the appropriate gains/losses RACs.

31. All exchange differences, whether arising on settled or unsettled transactions, should be charged/credited to the Department's SOCNE.

32. Exchange differences should be recorded by the TLB that holds the related foreign currency assets and liabilities or enters into a transaction denominated in a foreign currency.

Accounting at the Year End and 'Hard Close' Reporting Periods Ends

33. At each reporting period and at year-end, foreign currency monetary assets and liabilities (for example, cash and cash equivalent balances, payables and receivables) should be translated into sterling using the published 'hard close' period end or the year end mid-market closing rate.

34. The revaluation of a Non-Current Asset (NCA) or any other non-monetary asset or liability, expressed in a foreign currency should be translated back into sterling at the date of the revised revaluation. Where an annual review of an NCA does not result in a change to its foreign currency value, the value of the asset will still need to be re-translated into sterling at the exchange rate prevailing at the date of the review. Where non-monetary assets and liabilities are not revalued, their values should not be retranslated.

Disclosure

35. The following disclosures should be made in the financial statements:

a. the translation method used (i.e. based on the functional currency);

b. the amount of exchange differences (net) charged or credited to the SOCNE;

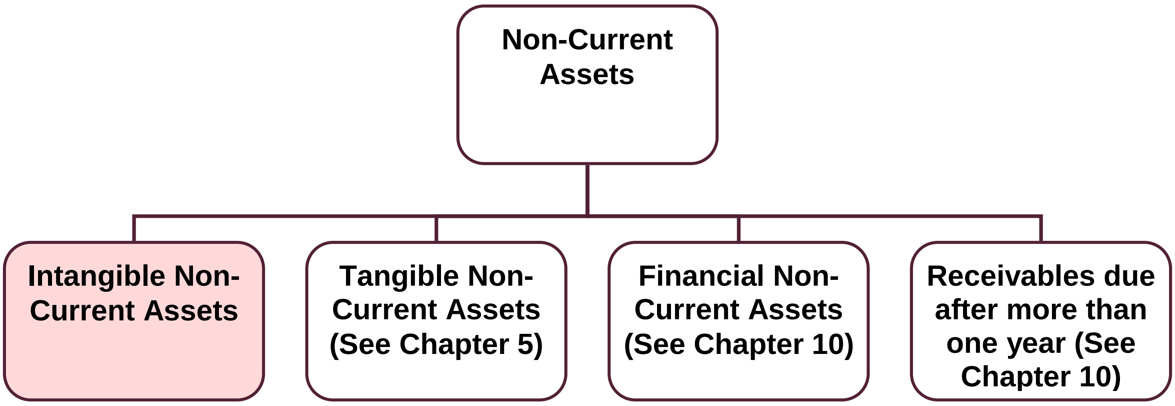
c. the value of foreign exchange forward contracts.

Guidance

36. There is no guidance on accounting for expenditure in Part 2.

This publication has been archived on 13 September 2016. The latest edition is available through the Defence Intranet.

4 Intangible Non-Current Assets



Introduction

1. This chapter sets out the accounting requirements for intangible Non-Current Assets (NCAs).

Specific Responsibilities

FMPA Accounting and Treasury Management Team (FMPA A&TM)

2. FMPA A&TM is responsible for:

a. approving any exceptions to intangible NCA useful lives;

b. approving proposals to capitalise development costs prior to Main Gate;

c. reviewing cases to transfer assets to other government departments for no consideration as HM Treasury approval is required.

Managing Owners

3. Managing Owners have financial management responsibilities for any intangible assets which relate to the tangible NCAs that they are responsible for. They are responsible for ensuring that:

a. intangible assets are recorded on a Non-Current Asset Register (NCAR) or equivalent accounting record with evidence that their values are complete and accurate;

b. intangible assets are linked to the related tangible NCA;

c. intangible asset lives are realistic;

d. intangible asset remaining lives are reviewed annually to ensure they are still consistent with plans for the assets further use;

e. intangible assets are consistently accounted for in accordance with the policy set out in this chapter;

f. evidence is maintained to demonstrate that the coding of intangible assets to the General Ledger is accurate;

g. Asset Change Notices (ACNs) should be approved by an individual with sufficient authority to confirm the assets' characteristics are correct and this should not be the same individual who submits the ACN to the DBS Finance and Asset Data Management Team (FAADMT).

The DBS Finance and Asset Data Management Team

4. The DBS FAADMT is resposible for:

a. maintaining, updating and processing NCARs;

b. completing the ACN forms with evidence of the name of the person checking and processing the ACN form.

Recognition

5. An intangible NCA is an identifiable asset without physical substance. Examples most likely to arise within the Department are development costs, Intellectual Property Rights (IPR), software and software licences. Although greenhouse gas emission allowances are generally accounted for as an intangible NCA, for materiality reasons, the Department does not account for them as an intangible NCA – see Part 1 Chapter 4 paragraph 59.

6. An intangible NCA is recognised when:

a. it is held for use in the delivery of Departmental objectives or for administrative purposes; and

b. it has been acquired or is being developed with the intention of being used on a continuing basis for a period in excess of one year; and

c. the cost of the asset can be measured reliably (for example, it will generally be separately identifiable throughout its life); and

d. it is probable that future economic benefits associated with the asset will flow to the Department; and

e. it is above the Department's capitalisation threshold of £25,000.

Costs to be Capitalised on Recognition

7. Intangible NCAs are recognised on an accruals basis at their cost of acquisition or creation. All costs directly attributable to creating and producing an intangible NCA for its intended purpose should be capitalised. Examples are given in Part 2 Chapter 4 paragraph 2.

8. VAT paid on development expenditure may be recoverable. Guidance on whether VAT is recoverable for a particular category of development cost should initially be sought from TLB Tax Focal Points. Recoverable VAT should not be included in the capitalised value of development costs – see JSP 916.

9. Where the Department's own staff are involved in the acquisition, creation or development of an intangible NCA, the relevant proportion of the internal costs which relate to those staff should, if material, be included in the cost of the asset, provided that the other criteria for capitalisation are met.

10. Information on intangible NCAs purchased in foreign currencies is covered in Part 1 Chapter 3.

Categorisation

11. The principal intangible NCA categories are: development expenditure - on SUME items; development expenditure - for example, on software and other intangible assets – such as software licences.

Research and Development

12. Development is defined as the application of research findings or other scientific or technical knowledge to produce new or substantially improved materials, devices, products or services before commencement of production or use.

13. Research expenditure is not treated as an intangible asset, as there is no evidence that it will result in an intangible asset that will give rise to probable future service potential. As such, it is written off as incurred.

14. At the inception of contracts (usually after Main Gate), planned expenditure is analysed and allocated to relevant account codes to record expenditure and capitalised

items in the General Ledger. The Financial Controllers in Project Teams (or their equivalent) should physically or electronically record evidence that they have reviewed the proposed coding to the General Ledger and confirm that they are satisfied with its accuracy for those costs that should be expensed or capitalised.

Other Intangible Assets

15. IPR includes, for example, concessions, patents, licences, copyrights, trademarks, databases and similar rights and assets.

16. Software licences confer the right to others to use software developed by third parties. Software (other than the operating system) which is owned by the Department and used in connection with providing a product or service to a body outside the Departmental boundary should be capitalised as an intangible asset if it meets criteria identified in Part 1 Chapter 4 paragraph 53.

17. Goodwill is classified as an intangible asset but is not normally expected to arise within the Department.

Measurement after Recognition

Valuation

18. After initial recognition, intangible NCAs should be revalued on the following basis:

a. intangible NCA Assets Under Construction (AUC) balances - it is usual for contract costs to already reflect current costs meaning intangible NCA AUC balances are already at fair value. Therefore, indexation should not be applied to intangible NCA AUC balances where contract costs already include price inflation. The rationale for indexing or not indexing intangible NCA AUC must be retained to ensure that there is robust documentation available to auditors.

b. where an active (homogeneous) market exists, intangible assets, other than those that are held for sale, should be carried at current (market) value in existing use;

c. where no market exists, indices should be used to revalue the intangible asset to the lower of Depreciated Replacement Cost (DRC) and value in use if the asset is income generating;

d. where there is no value in use, the intangible asset should be valued at DRC.

19. The above bases are a proxy for fair value. Further details on the specific accounting requirements can be found in Part 1 Chapter 4 paragraphs 32 to 60.

Amortisation

20. Intangible NCAs are amortised over their estimated useful economic life except for intangible NCA Assets Under Construction balances which are not amortised.

21. Straight line amortisation is applied as shown in Figure 1 below.

22. Any proposed variations to lives outside the ranges shown in Figure 1 should be agreed with FMPA A&TM.

23. TLBs should review intangible NCAs remaining lives at least annually to ensure they are still consistent with plans for the assets further use. Where inconsistency is identified, action should be taken to re-life or re-value the asset through FAADMT before the asset becomes life expired.

24. Where a range of lives is given, the TLB is responsible for determining which is the most appropriate.

25. A full month's amortisation is charged in the month of transfer in, purchase or commissioning. No amortisation is charged in the month of transfer out or disposal.

26. If estimated useful economic lives or residual values are amended, the unamortised cost is written off prospectively over the remaining asset life.

Figure 1

Intangible NCA Category	Asset Life
Development costs (including SUME development)	Useful life of the tangible NCA to which it relates
Intellectual property rights (IPR)	Useful life (determined by D/IPR)
Software licences	The shorter of expected life or licence period

Transactions Between Government Departments

27. The transfer of intangible NCAs to another government department, except under a transfer of function or a merger of departments, should be treated as a normal commercial transaction, i.e. a sale. Assets transferred in this way should be transferred at fair value.

28. For intangible assets, fair value should usually be based on DRC.

29. If assets transfer for no consideration FMPA A&TM must be consulted, as HM Treasury approval is required.

Disclosure

30. Intangible NCAs are disclosed in the Annual Accounts under the following headings:

a. SUME;

b. software;

c. other intangible assets.

31. The disclosure note for intangible assets must explain the basis on which each category of intangible NCA has been valued.

Specific Accounting Requirements

32. Specific intangible NCA accounting treatments are set out in the following paragraphs.

Research and Development Costs

33. The accounting treatment depends on whether expenditure is defined as research expenditure or development expenditure:

a. research expenditure is defined as original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. Examples are given in Part 2 Chapter 4 paragraph 4.

b. development expenditure is the application of research findings or other knowledge to a plan or a design for producing new or substantially improved material, devices, products, processes, systems or services before commencement of production or use. Examples are given in Part 2 Chapter 4 paragraph 4.

34. All expenditure on research should be expensed to the Statement of Comprehensive Net Expenditure (SOCNE) in the year in which it is incurred.

35. The Department must capitalise development cost expenditure which meets all of the following criteria:

a. the development expenditure relating to the project is separately identifiable and can be measured reliably;

b. adequate technical, financial and other resources are available to enable project completion and implementation of results;

c. it is intended that the project will be completed and will result in an asset or service that will eventually be brought into use to generate probable future economic benefits;

d. the project is technically feasible.

36. Development costs which do not meet the above criteria should be expensed to the SOCNE. In addition, the TLB managing the procurement should treat all costs associated with, for example, failed designs and technological advances which arise between original project inception and final commissioning as abortive costs, expensing them to the SOCNE on recognition or, exceptionally, on project completion.

37. The dividing line between research and development expenditure is often indistinct and some expenditure may have the characteristics of more than one category. The Main Gate approval stage within the CADMID project life cycle is often cited as a dividing line between research expenditure and development expenditure. However, although this approval hurdle may act as a useful guide for deciding whether to record the expenditure as research or development expenditure, the correlation between certain stages in the CADMID cycle and certain types of expenditure should not be viewed as a hard and fast decision rule.

38. Any proposal to capitalise development costs prior to Main Gate must be approved by FMPA A&TM.

39. All costs directly attributable to the development project should be capitalised, provided that they meet the definition of development costs and the general criteria for capitalisation as an intangible asset.

40. Development expenditure meeting the criteria in Part 1 Chapter 4 paragraph 35 may be incurred in relation to NCA development projects or to development projects which will be subsequently treated as RMC within the Department's supply systems.

41. Development costs should be recorded at their current value. As such they are subject to indexation. The price indices applied to development expenditure should be the same as those applied to the underlying NCAs to which the development expenditure relates.

42. Development costs are subject to the same review processes (for example, impairment and remaining life) that are applied to NCAs in general and should be amortised over their useful economic life. The useful economic life of a development cost intangible NCA should never extend beyond the economic life of the underlying tangible NCA or the RMC item to which it relates.

Transfer of Development Costs on Project Completion

43. Details are provided in Part 2 Chapter 4 paragraphs 5 to 32 on how development costs should be transferred on project completion in relation to: NCAs on the NCAR; NCAs held on the Supply Systems; and RMCs.

Intellectual Property Rights

44. On initial recognition, IPR purchased separately from a business should be capitalised at cost.

45. IPR which are developed in-house by the Department are only capitalised if they already have (or subsequently acquire) a readily ascertainable market value. This means the asset must belong to a homogeneous population of assets and also that an active market, evidenced by frequent transactions, exists for them.

46. IPRs are to be amortised over their assessed useful economic life, which is to be determined in conjunction with Defence Intellectual Property Rights (DIPR).

47. IPR are regarded as impaired if their recoverable amount (i.e. the higher of net realisable amount and value in use) falls below their carrying amount. Annual impairment reviews are performed to ensure that IPR are not carried at a value which exceeds their recoverable amount. The first review should be carried out at the end of the first full financial year following initial recognition of the intangible asset on the SOFP.

48. IPR with readily ascertainable market values are revalued by reference to these market values.

49. Reversal of a past impairment can only be recognised if it is clearly attributable to an unforeseen reversal of the external event that led to the impairment. Past impairments cannot be reversed if the restoration in value is internally generated.

50. The majority of IPR are held by the Department's commercial contractors and the Department normally secures 'freedom of use' during the time that the asset is in service. Consequently, any IPR element will invariably be included in the overall project development cost and will be indistinguishable from the direct cost of the asset. Therefore, as IPR are only of value while the Department is using the asset and cannot be sold separately to a third party, it is not appropriate in such circumstances to attempt to identify an IPR element.

51. Where IPR arises from Departmental in-house research and development work, costs which meet the capitalisation threshold of £25,000 must be capitalised as part of the project development costs. The only exception to this is where the IPR is separately identifiable, has a readily ascertainable market value and is material in nature (for example, where the Department has a right to a Commercial Exploitation Levy as the result of a contractor exploiting Departmental funded work).

Software

52. Software which is purchased from a third party for internal business use should be capitalised as an intangible asset. Software which the Department develops internally for its own use should only be capitalised as an intangible asset if it meets the criteria in Part 1 Chapter 4 paragraph 35. Any software that is integral to the operation of the hardware should generally be capitalised as part of the hardware, although this will depend on

whether the tangible or intangible element is the more significant. Further details are given in Part 2 Chapter 4.

53. Software costs incurred by the Department in connection with a product or service which is to be supplied to a body outside the Department should be capitalised as an intangible asset if the Department can demonstrate the following:

a. the technical feasibility of completing the project so that the software is available for sale;

b. its intention is to complete the software and sell it;

c. adequate technical, financial and other resources exist to complete the project and sell the software;

d. its ability to reliably measure and separately identify the expenditure incurred on developing the software, and that it is separately identifiable.

54. Any such software intangible assets should be amortised on a systematic basis over the period in which the related product or service will be sold or provided for use.

55. Software licences confer the right to use software developed by third parties. Where the Department has the right to use software under a licence and this contributes to the provision of services or other Departmental outputs for a period in excess of one year, the cost of the licence must be capitalised as an intangible asset and amortised over the shorter of its economic life or the licence period.

Website Costs

56. If TLBs have developed websites for internal or external access, the development costs are capitalised as part of the cost of the internally generated intangible asset provided that the requirements of Part 1 Chapter 4 paragraph 35 are met.

57. If a website is capitalised as an intangible NCA, a conservative view should be taken of its useful life.

Carbon Reduction Commitment Energy Efficiency Scheme (and Similar Schemes)

58. The MOD participates in both the Carbon Reduction Commitment Energy Efficiency Scheme (the CRC Scheme) and the EU Emissions Trading Scheme (ETS).

59. The CRC and the ETS should be accounted for in accordance with Part 2 Chapter 4 paragraphs 55 to 64. However, for materiality reasons, the Department does not fully comply with the CRC and ETS accounting requirements. Instead, the Department reflects purchases and sales of allowances as an expense or income in the SOCNE. All other

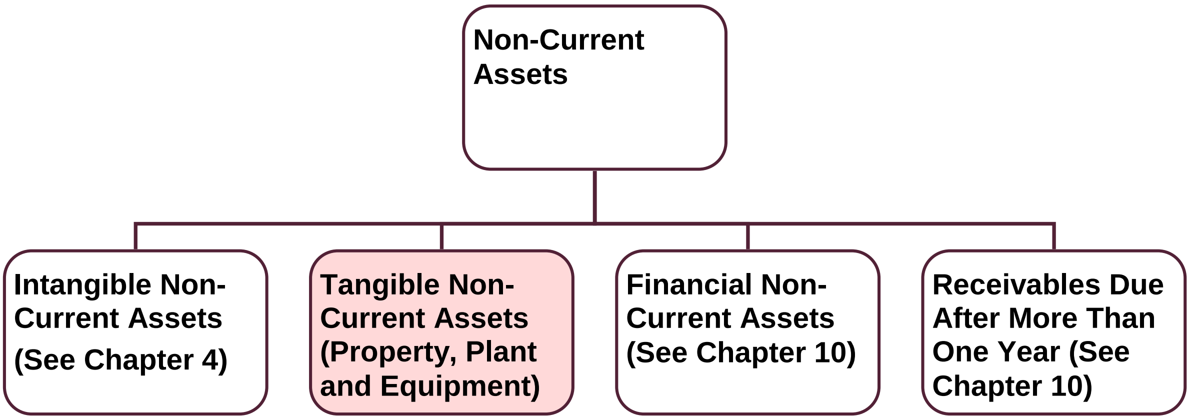
costs associated with the scheme, such as fines and compliance checking, are charged to the SOCNE.

60. The NAO has previously been satisfied that this departure is unlikely to have a material impact on the Annual Accounts. However, the NAO will need to confirm this each year by reviewing the calculations and underlying assumptions used to form the materiality judgement.

Guidance

61. Further details is given in Part 2 Chapter 4 on: costs to be capitalised; research and development costs; transfer of development costs on project completion; how to account for the cost of software which is either purchased by the Department or developed in house; Carbon Reduction Commitment Energy Efficiency Scheme (and Similar Schemes).

5 Tangible Non-Current Assets



Introduction

1. This chapter sets out the accounting requirements for tangible Non-Current Assets (NCAs), including capital spares and Guided Weapons, Missiles and Bombs (GWMB) which are recorded on a supply system rather than on a Non-Current Asset Register (NCAR).

Specific Responsibilities

2. Specific responsibilities are listed below.

FMPA Accounting and Treasury Management (FMPA A&TM)

3. FMPA A&TM is responsible for:

   a. agreeing capitalisation thresholds with HM Treasury;

Managing Owners

4. Managing Owners should (in respect of the NCAs they are responsible for):

   a. ensure that NCA accounting policy is correctly applied;

   b. ensure the safe custody and physical control of the NCAs;

   c. physically verify NCAs;

d. transfer locally acquired NCAs, using NCA clearing accounts, for inclusion in the NCAR and also the SOFP.

e. ensure that NCAs are included on their SOFP and recorded on the NCAR;

f. ensure that NCA accounts are true and fair, including reviewing valuations;

g. ensure that NCAs are physically verified;

h. allocate each of their NCAs to the appropriate NCA category;

i. ensure that all items identified as ancillary, composite or grouped assets are correctly recorded in an NCAR;

j. ensure that financial accounting policy is consistently applied to capital spares and GWMB;

k. ensure that all valued heritage assets, with the assistance of the DBS Finance and Asset Data Management Team (FAADMT), are entered onto the NCAR;

l. identifying NCAs for disposal;

m. maintain a separate register of unvalued non-operational heritage assets which meets the disclosure requirements;

n. ensure that all NCAs in use are depreciated at an appropriate rate and that their life and residual value are periodically reassessed;

o. approve Asset Change Notices (ACNs) by an individual with sufficient authority to confirm the assets' characteristics are correct and this should not be the same individual who submits the ACN to the DBS Finance and Asset Data Management Team (FAADMT).

The DBS Finance and Asset Data Management Team

5. The FAADMT is responsible for:

a. processing Asset Change Notifications and maintaining and updating NCARs;

b. recording on the ACN forms the name of the person checking and processing the ACN form;

c. managing the NCA verification process.

Categorisation

6. Tangible NCAs, including those held under a finance lease, are analysed into major categories which comply with HM Treasury's Whole of Government Accounts (WGA) and the European System of Accounts 10 (ESA10) disclosure requirements. The major categories are as follows:

a. Land, Buildings and Dwellings;

b. Single Use Military Equipment (SUME);

c. Transport Equipment;

d. Plant and Machinery;

e. IT and Communications Equipment;

f. Assets Under Construction (AUC);

g. Capital Spares;

h. Guided Weapons, Missiles and Bombs.

7. Further details on the factors that should be taken into consideration when categorising tangible NCAs are given in Part 2 Chapter 5 paragraphs 2 to 23.

8. Construction contract balances (including work classified as long term contracts) relate to work which the Department undertakes for external repayment customers (including OGDs). Balances are accounted for within receivables but are not re-valued to current values. See Part 1 Chapter 3 paragraph 6.

Recognition

9. A tangible NCA is defined as, and recognised when, an item displays all of the following characteristics:

a. it is held for use in delivering Departmental objectives or for administrative purposes;

b. it has been acquired or is being constructed with the intention of being used on a continuing basis for a period in excess of one year;

c. the cost of the item can be measured reliably. For example, it will generally remain separately identifiable throughout its life;

d. it is probable that future economic benefits associated with the item will flow to the Department;

e. it is above the Department's £25,000 capitalisation threshold (No capitalisation threshold is applied to non-current assets, capital spares or GWMB held on the supply systems or by Industry partners. For accounting purposes, these assets are treated as pooled and included within the SUME category of tangible NCAs.

10. When an NCA that is not held on a supply system meets the capitalisation threshold and is recorded on an NCAR, it is treated as an NCA regardless of any subsequent impairment which might cause its value to fall below the capitalisation threshold. Similarly, when an asset is classed as below the threshold and expensed to the Statement of Comprehensive Net Expenditure (SOCNE), it should not be reclassified as an NCA if, as a result of revaluation, it then meets the capitalisation threshold.

11. NCAs that do not meet the capitalisation threshold (either on an individual or grouped basis) and low value articles in use should be expensed to the SOCNE as incurred or on issue from the supplying inventory management system. Items written off must continue to be properly recorded and controlled via, for example, permanent loan records and articles in use registers under existing Departmental Materiel Accounting Regulations.

12. Although held as inventory items on the supply system, for financial reporting purposes both GWMB (NCA Resource Account Codes (RACs)) and CS (inventory RACs) are disclosed as NCAs in the Annual Accounts. It should however be noted that the capitalisation threshold is not applied to these items.

Non-Current Assets on Loan

13. NCAs on loan to third parties are recorded on an NCAR and reported within the SOFP of the appropriate TLB with a record of the current location. For example, GFE and Government Owned-Contractor Operated (GOCO) establishments.

14. Where NCAs are loaned to the Department on a short-term basis - i.e. for less than one year - they should not be included in an NCAR or the accounts. They should, however, be properly recorded and controlled under Departmental Materiel Accounting Regulations.

15. Assets that are loaned to the Department for more than 12 months as part of a sponsorship arrangement (i.e. there is no cost to the Department) and meet the capitalisation threshold should be treated as donated assets (see Part 1 Chapter 2 paragraph 12). If the assets do not meet the capitalisation threshold, they should be recorded and controlled under Departmental Materiel Accounting Regulations.

Collaborative Projects

16. In most cases legal ownership of NCAs used within collaborative projects which are run by a Joint Project Office (JPO) rests with the JPO prior to completion.

17. NCAs created under collaborative projects and intended for Departmental use are recorded in project accounts. On completion, the NCAs are recorded on the NCAR.

18. Where NATO funds assets which are used by the Department, the asset should be capitalised at fair value and the NATO funded proportion accounted for in accordance with Part 1 Chapter 2 paragraph 12.

Items of Personal Equipment

19. Items of personal equipment below the Departmental capitalisation threshold, which are repairable and preserved for future use (for example, the Future Integrated Soldier Technology) should be accounted for as grouped NCAs or as Capital Spares where held on a MoD supply system or by industry partners under a management contract.

Articles in Use

20. Articles in use are items which are issued from forward stores but not deemed to be consumed by the end user – for example, torpedoes on a ship or items recorded within the Managed Joint Deployed Inventory (MJDI) System where accountability remains with the inventory holder even though the items have been issued forward. Articles in use are generally capital spares although there may be low value exceptions – for examples, bullets issued for guarding purposes.

21. Articles in use are deemed to have passed the point of consumption unless capitalised as an NCA, either individually or on a group basis or managed as a Capital Spare. Articles in use are subsequently surrendered and accounted for as returned items if previously treated as consumed (written off).

Arm's Length Bodies

22. Arm's Length Bodies (ALBs), including Agencies, may have agreed lower materiality thresholds with their auditors for their own Accounts. If assets are being transferred from an Arm's Length Body to the Department and the original gross cost of the assets are below the Department's capitalisation threshold, then the assets should be expensed in the Department's accounts. It is the responsibility of the ALB to maintain 'off-line' records for their own Accounts if they have a lower capitalisation threshold.

23. An Agency should only recognise NCAs on its SOFP where the risks and rewards of ownership lie with the Agency, as opposed to the Department. Assets such as these will be bespoke to the Agency's business (i.e. not subject to any form of Departmental whole fleet management regime), will be material to its business and will have restrictions on their use, for example, donated assets, operational heritage assets, assets under PFI deals and assets held for charitable use. Responsibility for maintaining them is expected to fall directly to the Agency.

Cost Recognition

24. Tangible NCAs are recognised on an accruals basis at their cost of acquisition or creation. See Part 2 Chapter 5 paragraphs 56 to 59 for further details on capitalising the cost of capital spares and GWMB. All costs directly attributable to bringing the tangible NCA into its working condition for its intended use should be capitalised. These costs comprise:

a. the asset's purchase price, including import duties and non-recoverable VAT, less any trade discounts and rebates;

b. any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by the Department;

c. the initial estimated cost of dismantling and removing the item and restoring the site on which it is located, to the extent that it can be recognised and measured in accordance with IAS 37, 'Provisions, contingent liabilities and contingent assets'. This obligation will fall to the Department either when the item is acquired or as a consequence of the Department having used it during a particular period for purposes other than producing inventory. Note that if an item is used for producing inventory, IAS 2, 'Inventories' applies and the cost is included in the item's carrying amount.

25. Examples of directly attributable costs are:

a. the cost of site preparation;

b. initial delivery and handling costs;

c. installation and assembly costs;

d. the cost of testing whether the asset is functioning properly, after having deducted the net proceeds from selling any items produced in bringing the asset to its present location and condition (for example, samples produced when testing equipment);

e. professional fees.

26. Where the Department's own staff are involved in the acquisition or construction of a NCA, the relevant proportion of the internal costs relating to those staff should, if material, be included in the cost of the asset, provided that the other capitalisation criteria are met.

27. Where internal costs are capitalised they will include the Department's employees' salaries and expenses which arise directly from the construction or acquisition of the specific NCA.

28. Administration and other general overhead costs should be excluded from the cost. Employee costs which do not relate to the specific asset are not directly attributable costs and should therefore not be capitalised.

29. Borrowing costs are the interest and other costs incurred in borrowing funds to finance the acquisition, construction or production of a qualifying asset (i.e. one that takes a substantial period of time to prepare for its intended use or for sale). Borrowing costs incurred on the construction of assets should be expensed.

Retention Payments

30. Retention payments are amounts which the Department withholds from the contractor until it is content that the contractor's work has been completed satisfactorily.

31. Where there is a binding contract a retention payment should be accounted for as follows:

a. if it is judged fairly certain that the Department will pay the retained amount, it should be accrued for and reflected in the value of the non-current asset;

b. if it is judged probable that the Department will pay the retained amount, a provision should be created and the amount reflected in the value of the non-current asset;

c. if it is judged only possible that the Department will pay the retained amount, it should (if sufficiently material) be disclosed as a contingent liability (but not reflected in the value of the non-current asset).

32. Donated NCAs, assets obtained under a finance lease, and assets funded by grants should be reported on the SOFP and separately identified on an NCAR in the same way as purchased NCAs.

Measurement after Recognition

33. NCAs are initially measured at cost and then revalued to fair value, which is based on market-based evidence or value by appraisal. If fair value cannot be determined, DRC is used as a proxy. In respect of AUC, it is usual for contract costs to already reflect current costs and if this is the case, AUC balances are already at fair value. Therefore, indexation should not be applied to AUC where contract costs already include price inflation. The rationale for indexing or not indexing AUC must be retained to ensure that there is robust documentation available to auditors.

Valuation of Assets

34. It is for valuers, using the Royal Institute of Chartered Surveyors' (RICS) 'Red Book' (RICS Appraisal and Valuation Standards), and following discussions with the Department,

to determine the most appropriate methodology for obtaining either a current value in existing use or a fair value.

35. Assets which are held for their service potential (i.e. operational assets used to deliver either front line services or back office functions) should be measured at their current value in existing use. For non-specialist assets, current value in existing use should be interpreted as market value in existing use which is defined in the RICS Red Book as Existing Use Value (EUV). For specialist assets, current value in existing use should be interpreted as the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing the service potential.

36. Assets which were most recently held for their service potential but are surplus, should be valued at current value in existing use as per Part 1 Chapter 5 Paragraph 35 if there are restrictions on the Department or the asset which would prevent access to the market at the reporting date. If the entity could access the market, then the surplus asset should be valued ar fair value using IFRS 13, Fair Value Measurement – see Part 1 Chapter 5 Paragraph 50.

37. In determining whether an asset which is not in use is surplus, the Department should assess whether there is a clear plan to bring the asset back into future use as an operational asset. Where there is a clear plan, the asset is not surplus and the current value in existing use should be maintained. Otherwise, the asset should be assessed as being surplus and valued under IFRS 13, Fair Value Measurement.

38. Assets which are not held for their service potential should be valued in accordance with IFRS 5 (see Part 1 Chapter 5 Paragraph 135) or IAS 40 – Investment Property depending on whether the asset is actively held for sale.

39. Where an asset is not being used to deliver services and there is no plan to bring it back into use, with no restrictions on sale, and it does not meet the IAS 40 (Investment Property) and IFRS 5 (Non Current Assets Held for Sale and Discontinued Operations) criteria, these assets are surplus and should be valued at fair value using IFRS 13 (Fair Value Measurement).

40. Where a valuer, following discussions with the Department, determined that Depreciated Replacement Cost (DRC) is the most appropriate measure of current value in existing use, the Department and their valuers should have regard to the guidance contained in the most recent RICS Red Book.

41. Where DRC is used as the valuation methodology:

a. the Department should normally value a modern equivalent asset in line with the RICS Red Book. Any plans to value a reproduction of the existing asset instead should be discussed with the MOD Accounting Policy Team as HM Treasury will need to be consulted to determine if such an approach is appropriate to the Department's circumstances;

b. the Department should use the 'instant build' approach;

c. the choice of alternative site will normally hinge on the policy in respect of the location requirements of the service being provided.

42. The cost of enhancements to existing assets (such as building a new wing to a building) should be capitalised during the construction phase as an asset under construction. At first valuation after the asset is brought into use, any write down of cost should be treated as an impairment and charged to the SOCNE.

43. Certain infrastructure NCAs and items of plant and machinery are included within a property valuation due to their integrated nature – for example, utility supply cables and piping, heating systems, roads, boundary fences and mains drainage. Where an NCA is primarily installed to provide services to the buildings, it is valued as part of the buildings.

44. New IT and Communications cable installations should not be treated as infrastructure assets. See Part 2 Chapter 5 paragraph 120 for more details.

45. Refer to the RICS Red Book for details of items of plant and machinery normally included in land and buildings valuations. This information is available from DIO.

46. All property NCA values should be periodically reviewed and updated. This is achieved through a mixture of professional valuation (i.e the quinquennial review (QQR)) which is a professional revaluation at intervals of not more than five years)) and the application of appropriate price indices with no interim professional revaluation. However, the assets' existing values should be updated if, in the opinion of DIO, in discussion with the appropriate TLBs, there is likely to have been a material change in value during the intervening years and it has not been reflected through the application of indices. Property assets are also subject to an annual impairment review.

47. As part of the QQR, a valuer's report and certificate are required together with a documented process of the review and validation of data.

48. All non-property NCA values held on the NCAR (See Part 2 Chapter 5 paragraphs 60 to 62 for the treatment of assets held on a supply system) should be periodically reviewed and updated, which is achieved by applying appropriate price indices. Plant and equipment NCAs are subject to an annual impairment review.

49. It should be ensured that NCAs whose values are expressed in a foreign currency are re-valued to reflect both the movement in asset value expressed in the foreign currency and the movement in the sterling exchange rate.

50. IFRS 13 (Fair Value Measurement) defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e. an exit price). This fair value measurement takes into account a market participant's abilitity to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use it in its highest and best use. The highest and best use takes into account the use of the asset that is physically possible, legally permissible and financial feasible. Refer to the Standard for full details.

Revaluation Accounting Treatment

51. The revaluation accounting treatment described below only applies to assets held on the NCAR. See Part 2 Chapter 5 paragraphs 63 to 72 for the treatment of assets held on a supply system.

52. An upward revaluation of an asset should be reflected as an increase to its carrying amount and credited to the Revaluation Reserve. However, if it reverses a revaluation loss previously recognised in the net operating cost section of the SOCNE, the amount of the credit which can be matched to the previous charge should be taken to the net operating cost section of the SOCNE and the remainder to the Revaluation Reserve.

53. Downward revaluations which are due solely to fluctuations in market value are to be written off against the Revaluation Reserve until the carrying amount reaches the level of depreciated historical cost. For this purpose 'historical cost' means the value at which an asset was first recorded on the NCAR 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. Any further downward revaluation should be recognised in the net operating cost section of the SOCNE as detailed in Part 1 Chapter 5 paragraph 62.

<u>Revaluation Reserve</u>

54. The Revaluation Reserve reflects the cumulative balance of indexation and revaluation adjustments to NCAs, current asset investments in marketable securities and inventory. It comprises two elements:

a. the in-year revaluation;

b. the backlog amortisation/depreciation

55. Each year the realised element of the Revaluation Reserve, i.e. an amount equal to the excess of the actual depreciation over depreciation based on historical cost, is transferred from the reserve to the General Fund.

56. Backlog amortisation/depreciation represents the additional amount that would have been charged in prior years if the asset had been valued at today's price from initial purchase. This 'under amortisation/depreciation' resulting from earlier years is debited to the Revaluation Reserve.

Impairment

57. Assets should be carried at no more than their recoverable amount, i.e. the amount recoverable through use or sale. For the Department, value in use for an asset that is not held for the purpose of generating cash flows is assumed to equal the cost of replacing the service potential provided by the asset, unless there has been a reduction in service potential.

58. Where the carrying amount of an asset exceeds its recoverable amount, an impairment loss should be recognised. It should then be established whether any of the impairment loss is a result of:

a. a consumption of economic benefit or a reduction in service potential (including as a result of loss or damage resulting from normal business operations); or

b. a change in the market price.

59. Assets that are damaged but repairable, and have a repair loop available, are not required to be impaired as long as the repair work carried out restores the asset to its original specification/previous capability before the damage. Where no impairment is made the repair costs should be expensed. When a repair is undertaken and the asset is not brought up to its original specification/previous capability before the damage, the impairment is the gap between the asset's original capability/previous capability before the damage and the capability after the repair. Where the repair work enhances either the life or capability of the asset beyond its original specification/previous capability before the damage then the costs associated with this enhancement element only should be considered for capitalised in accordance with Part 1 Chapter 5 paragraph 69.

60. Examples of impairments arising from a consumption of economic benefit or a reduction in service potential are:

a. disposal of equipment where the sale is likely to complete within 12 months. These assets should be valued at the lower of their carrying amount and their fair value less costs to sell. Any write-down of the asset should be recognised as an impairment in accordance with Part 1 Chapter 5 paragraph 135;

b. assets which remain in service but at a reduced capability. The asset should be impaired to reflect its revised service potential;

c. use of an asset for a lower specification use;

d. losses as a result of loss or damage (but see Part 1 Chapter 5 paragraph 59);

e. abandonment of projects;

f. gold plating of asset.

61. Impairments such as those examples in Part 1 Chapter 5 paragraph 60 must be reflected immediately, regardless of whether a Board of Inquiry is to be held or a decision has yet to be taken on whether the asset is to be written off or repaired.

62. A fall in value relating to a consumption of economic benefit or reduction in service potential should be taken to the net operating cost section of the SOCNE. Any balance within the Revaluation Reserve (up to the level of the impairment) to which the impairment would have been charged under IAS 36 should be transferred to the General Fund.

63. A fall in value relating to changes in market price should first be offset against the Revaluation Reserve for the asset in question (if there is one) until that element of the Revaluation Reserve is exhausted and the carrying amount of the asset reaches the level of depreciated historical cost. For this purpose 'historical' refers to the value at which the asset was taken on to the NCAR if no historical cost information was available. The write-off should only be made against that proportion of the credit balance on the Revaluation Reserve that relates to the asset concerned. Downward revaluations below this should then be recognised in the SOCNE (net operating cost section).

64. In circumstances where an asset is scrapped, destroyed, sold for scrap or lost, the reduction in value is charged to the NCA write-off account (MKB range) and not to an impairment heading. The sale of an asset for scrap is deemed equivalent to a write-off, as any income is incidental.

65. The Managing Owner of the assets should carry out an overall review of assets for impairment, applying local knowledge and experience as appropriate, so that at the end of each financial year any impairments are identified and evidence recorded of the annual review. Any impairments should be communicated to the DBS FAADMT to enable the NCAR to be updated. The assumptions made in estimating the amount of the impairment (if any) should be documented. The assumptions should be reviewed at the end of each financial year to reassess their validity and, if necessary, to recalculate the impairment estimate.

Impairment Reversals

66. Where an impairment (up to depreciated historical cost) has been charged to the net operating cost section of the SOCNE and the impairment is subsequently reversed, the reversal is also accounted for in the net operating cost section of the SOCNE. Any further increase in an asset's value above its depreciated historical cost should be taken through the Revaluation Reserve.

Budgetary Treatment

67. In budgetary terms, certain impairments will score as DEL and others as AME. The budgetary treatment does not influence the accounting treatment. However, the Department may need to disclose information in the Annual Accounts about the type and cause of impairment if the amounts are significant. The budgetary treatment is stated in the Department's IYM instructions and Defence Resources should be contacted if necessary.

Componentisation and Subsequent Expenditure

Componentisation

68. Where components of a tangible NCA (excluding capital spares and GWMB) have a cost that is significant in relation to the asset's overall cost, each should be separately depreciated.

Subsequent Expenditure

69. Subsequent expenditure on an NCA is capitalised when the following two criteria are met:

a. it is probable that future economic benefits associated with the asset will flow to the entity;

b. the cost of the asset can be measured reliably.

70. Where subsequent expenditure is capitalised, the carrying amount of the part which is being replaced must be derecognised, even if it has been separately depreciated. However, see the following paragraphs.

71. Expenditure on labour and consumables, including the cost of small parts (i.e. day to day servicing or repairs and maintenance) is expensed to the SOCNE, as it does not meet the recognition criteria in Part 1 Chapter 5 paragraph 69.

72. Parts of some tangible NCAs may need to be replaced at regular intervals over the life of the asset (for example, aircraft interiors such as seats) or they may only need to be replaced on an infrequent or non-recurring basis. The cost of the replacement part is recognised in the carrying amount of the tangible NCA under the recognition criteria in Part 1 Chapter 5 paragraph 69.

73. If it is not practicable to determine the carrying amount of the replaced part, the cost of the replacement can be used as an indication of the original acquisition/construction cost. The accounting treatment for different categories of NCAs is covered below.

Property Assets

<u>Componentisation</u>

74. Non-specialist new build property assets need not be componentised at the point of initial capitalisation, as the cost of any potential component is unlikely to be significant against the overall cost of the asset. However, this will need to be assessed on a case by case basis.

75. Specialist property assets such as runways should be componentised.

<u>Subsequent Expenditure</u>

76. Where subsequent expenditure covers the refurbishment of the majority of an existing asset, the cost should be capitalised and the total carrying amount of the replaced asset derecognised. Where only part of the asset is refurbished, the replaced element should be derecognised if the asset's carrying amount exceeds £500,000. The QQR will

correct any short term over/understatement of valuations. This materiality threshold should be reviewed on an annual basis.

Non-Property Assets – Sea Environment

77. Expenditure on repairs, other than during Major Refits and Overhauls (MRO), is charged to the SOCNE as incurred.

78. The decision on whether or not to capitalise subsequent expenditure will normally be determined by reference to the Equipment Plan (EP). However, the final decision will be agreed at the Main Gate approval stage of a project. DE&S should review the EP in the light of this guidance to determine the capital and revenue split. Once the decision to capitalise expenditure has been made within DE&S it should not normally be expensed subsequently.

79. Subsequent expenditure on a platform, whether related to an enhancement or a modification, should normally be expensed unless it meets the criteria in Part 1 Chapter 5 paragraph 69. In practice, this should result in the asset's capability or its life being significantly enhanced.

80. It is likely that expenditure to enhance or modify a ship or submarine will cover an upgrade to the whole (or significant proportion) of an asset class. Enhanced or modified assets are often identifiable by a change in their mark or role.

81. As part of the Annual Budget Cycle process, PTs managing enhancement packages of work should consult their TLB on the materiality of any expenditure on enhancements which occur between MROs. If appropriate, the PT should consider grouping a series of related enhancements to achieve a true and fair reflection of asset values and associated operating costs.

<u>Accounting for Major Refits and Overhauls (MRO)</u>

82. The principle aim of an MRO is to restore the operational capability that has already been consumed and reflected through depreciation. However, the opportunity to enhance the asset may also be taken, in which case care should be taken to separately identify enhancement costs and restoration costs.

83. Under MRO accounting only costs arising at the time of an MRO will be considered for capitalisation. The term MRO is intended to cover any instance of substantial base depot maintenance, during which significant expenditure is incurred, whether on refit, maintenance or upgrade work. Significant expenditure is defined as costs which are £1M or 10% of an asset's gross carrying amount, whichever is the higher. As with enhancements, PTs managing the package of work should, as part of Annual Budget Cycle process, consider grouping a series of related refits if this will result in a true and fair reflection of asset values and associated operating costs.

84. Subject to materiality considerations, expenditure on enhancements carried out

between MROs should be capitalised when the criteria in Part 1 Chapter 5 paragraph 69 are met. The cost should then be depreciated on an appropriate basis.

85. All expenditure on enhancements carried out during an MRO will be capitalised as part of the MRO regardless of financial criteria, even though this approach may result in minor accounting treatment inconsistencies for similar items.

86. Enhancements which share the same life as that of the core asset should be depreciated across the same period. Where an asset enhancement is capitalised, the associated development expenditure should also be capitalised.

87. In cases where asset enhancements are capitalised, TLBs will need to ensure that when adjusting the carrying amount of the principal asset, the value of the replaced element is also removed.

88. Where expenditure is expensed this is to be carried out by the PT responsible for managing or effecting the work package.

89. Subsequent expenditure on a major rebuild takes place when an existing type or mark of an asset is withdrawn completely from operational service to become the basic building block for its replacement, which will be fundamentally different in characteristics, role and performance. In such cases the withdrawn assets (i.e. those put into the programme for major rebuild) will have been written down to their expected recoverable amount and will be re-released into operational service based on their newly determined gross carrying amount. Where applicable, any new builds will be indistinguishable from rebuilt assets (i.e. they form a homogenous group). However, few assets will meet this strict definition.

90. Where material, the following costs should be capitalised:

a. external contractor costs;

b. Departmentally supplied materiel (including embodied capital spares);

c. RMC consumed;

d. direct internal labour and other costs which are incremental to the project.

91. Some capital spares will be removed and replaced at each MRO. Costs incurred on repairing them should continue to be expensed in line with current policy on capital spares.

92. Other expenditure – for example, station, line and afloat repairs, which maintain the asset at its previously assessed standard of performance – should be charged to the SOCNE as incurred.

Accounting for the Major Refit and Overhaul Element of New Assets

93. The decision on whether or not to apply MRO accounting to new assets will be made at the Main Gate submission stage

94. The PT will notify the appropriate TLB of the AUC cost to enable it to be split between:

a. the core asset cost, depreciated over the life of the core asset; and

b. the restoration cost, depreciated over the period to the first MRO.

95. The restoration cost element relates to the future cost of restoring the operational capability of the asset that will have been consumed by the time the first MRO occurs. This cost will usually be derived as the present value of the forecast cost of the first MRO, depreciated to the forecast date of that MRO. The sum of the core asset cost and restoration cost must equal the total AUC value transferred to the agreed receiving TLB. The agreed receiving TLB will hold the core and MRO assets on its SOFP and record them on the NCAR.

Accounting for the Major Refit and Overhaul Element of Existing Assets

96. Where it is necessary to apply MRO accounting to an existing asset to avoid materially misstating the accounts, the asset's value should be split between the core asset and the MRO element. The MRO value can be determined in one of two ways:

a. prior estimate - whereby the estimated costs and date of the last MRO are determined and the unamortised element calculated by using the projected date of the next MRO and interim indexation; or

b. future estimate - whereby the estimated costs and date of the next MRO are determined, adjusted for any difference between the projected level of cost inputs compared to the last MRO (where material), and also adjusted to reflect indexation and depreciation over the period between MROs.

97. In both cases, the calculated gross MRO cost is deducted from the carrying amount of the asset to determine the value of the core asset. There is no change to the total gross carrying amounts in the year of the most recent formal revaluation of the asset.

98. The core asset value should be depreciated over the useful economic life of the core asset. The MRO asset value should be depreciated over the period to the next MRO.

99. Where an asset will not be undergoing any further major refits, it can be excluded from MRO accounting.

100. Approval and advice should be sought from the CFAT team on whether it is appropriate to create a prior period adjustment when first applying MRO accounting to existing assets.

Non-Property Assets – Land Environment

101. Equipment assets within the Land Forces environment need not be componentised. Instead, subsequent expenditure should be expensed in the year in which it is incurred rather than capitalised and should be depreciated over the period to the next major refurbishment. This is because the rolling nature of the refurbishment programme results in an annual maintenance charge that is similar to the depreciation that would have been charged had the expenditure been capitalised.

102. To satisfy the NAO that the refurbishment costs recognised in the SOCNE are consistent with the economic benefits consumed over the same period, Land Command is required to provide NAO with the following information:

a. the current year value of the refurbishment costs recognised for assets;

b. the refurbishment costs incurred in each of the last three years;

c. the latest projected spend for refurbishment costs for the next five years.

103. If the NAO judges that the value or pattern of refurbishment costs could lead to a material misstatement, further evidence will be required to show that the condition of the asset base as a whole has not deteriorated over time and that the economic benefits of the assets are not being consumed more quickly than the refurbishment costs are being recognised in the accounts. This could be achieved, for example, by carrying out an annual condition survey. Further evidence will also be available from impairment reviews.

Non-Property Assets – Air Environment

104. Assets within the Air Environment need not be componentised. Therefore, subsequent expenditure should be expensed in the year in which it is incurred rather than being capitalised and depreciated over the period to the next major refurbishment. This is permissible on the grounds of materiality and practicality.

Depreciation

105. Depreciation is charged on all NCAs (including those in a supply system) except for:

a. land (unless held under a finance lease):

b. AUC;

c. operational heritage assets with an indefinite life;

d. assets held for sale or disposal.

106. Depreciation is charged on a straight line basis and allocates the gross carrying amount of tangible NCAs, less their estimated residual value (if this can be ascertained with reasonable certainty), evenly over their estimated useful life.

107. An NCA's useful life should be reviewed annually and, where appropriate, revised to reflect changing circumstances – e.g. arising from decisions taken in the latest finalised Annual Budget Cycle. All assumptions made in determining the estimated useful life should be documented and included in this annual review. Particular attention should be paid to assets which are nearing the end of their useful life or are subject to an extension to or/curtailment of their useful operational life. A regular review of asset lives will ensure that all assets used to deliver economic benefit are depreciated over the appropriate period. There should be no assets that are fully depreciated and remain in use and such situations cause complex adjustments to the NCARs. All TLBs must ensure they review regularly the useful life of assets approaching the end of their stated useful life to ensure that any adjustments that are needed to the life are made prior to the stated life expiry.

108. Where material, the residual values of NCAs should be reviewed annually and adjusted if appropriate. All assumptions should be documented.

109. A change to either the useful life or the residual value of an NCA should be accounted for prospectively over the asset's remaining useful life.

110. Any material variations to asset lives outside the ranges shown in Figure 2 must be cleared through FMPA A&TM as HM Treasury agreement is needed for significant changes.

111. Donated NCAs, assets funded by grants, leased assets, and PFI assets are all subject to depreciation in the same way as other assets.

112. Temporarily unused facilities are depreciated on the same basis as when they are in use.

113. Where a range of lives is given, the relevant TLB is responsible for determining the appropriate estimated useful life which should be applied to the NCA.

114. A full month's depreciation is charged in the month of transfer in, purchase or commissioning. No depreciation is charged in the month of transfer out or disposal.

115. If an estimated useful life or a residual value is amended, the carrying amount is written off prospectively over the asset's remaining life, with a consequential effect on amount of depreciation charged.

Figure 2	Category	Years
Tangible Non-current Assets:		
Land and Buildings	Land Buildings (dwellings and non-dwellings): - permanent - temporary Leasehold	Indefinite and not depreciated unless held under a finance lease. 40 – 50 5 – 20 Shorter of expected life and lease period.
Single Use Military Equipment (including GWMB)	Air Systems - Fixed Wing Air Systems – Rotary Wing Sea Systems – Surface Ships Sea Systems – Submarines Land Systems – Armoured Vehicles Land Systems – Small Arms	13 – 35 25 – 30 24 – 30 28 – 32 25 – 30 10 – 15
Plant and Machinery	Equipment Plant and Machinery	10 – 25 5 – 25
Transport	Air Systems – Fixed Wing Air Systems – Rotary Wing Sea Systems – Surface Ships Land Systems – Specialised Vehicles Land Systems – Other Standard Vehicles	25 – 35 15 – 32 20 – 30 15 – 30 3 – 5
IT and Communications Equipment	Office Machinery Communications Equipment	3 – 10 3 – 30
Capital Spares	Items of repairable material retained for the purpose of replacing parts of an asset undergoing repair, refurbishment, maintenance, servicing, modification, enhancement or conversion.	Use the same life as that of the prime equipment supported.
Operational Heritage Assets*		As for other tangible non-current assets.

*Operational Heritage Assets are separately disclosed within the principal asset category to which they relate.

Physical Verification

116. The existence of NCAs, other than those held on the supply system, is checked annually through a mixture of physical verification and other procedures. See Departmental Material Accounting Regulations.

117. Periodic physical verification of NCAs held on an NCAR is required for management control, for audit purposes and to substantiate the entries on the NCAR. This verification process is managed by DBS FAADMT on behalf of the TLBs.

118. Physical verification is facilitated through the use of a unique NCA identifier which is physically attached to each NCA. The unique NCA identifications are derived from existing serial numbers and identifiers. Part 2 Chapter 5 lists the non-financial data standards that are used to identify NCAs.

119. In addition, AUC balances are periodically reviewed to validate balances carried forward.

120. In rare cases, confirmation that an asset exists and is in use can replace physical verification - for example, verifying the existence of large IT platforms such as DII(F).

121. Verification includes a physical check of the asset against the asset register listing provided by the DBS FAADMT. However, for non-property assets, only those assets valued at over £100,000 require verification. User TLBs are also required to assess assets for any impairment caused through damage, obsolescence or shortening of their life and to confirm that assets have a continuing business use. The return is checked for completeness and any differences between the NCAR and the verification are identified and processed by the DBS FAADMT.

122. Where GFE is held on an NCAR, assets held at the contractor's premises must be physically verified. The Asset Accounting Centre audits defence contractors' systems and procedures to confirm that they are robust enough to safeguard GFE provided by the Department.

123. Wherever practicable, there must be a segregation of duties between the personnel undertaking physical verification and the NCA custodians.

124. Where a NCA is on temporary loan to another user, either in another part of the Department or to a third party, and it is impractical for the user TLB to physically inspect the NCA, arrangements must be made for the user TLB to confirm the NCA's existence. Third party user arrangements take the form of an annual certification.

Write-Ons

125. A write-on occurs when it is necessary to correct a previous failure to account for an NCA. Approval to treat the write-on as a prior period adjustment (coded to KAX000 – NCAs found in year) must be obtained from FMPA CFAT. Whilst approval is awaited, the value of the asset should be credited to MKC000 in the year in which the omission is discovered and must be retained within this account if approval is withheld.

Non-Current Assets Reclassified to Raw Materials and Consumables

126. When a change in function makes an NCA more akin to RMC, it is reclassified to RMC at its carrying amount. No profit or loss should arise on reclassification.

127. Errors in coding (i.e. RMC items wrongly coded to NCAs) that are rectified in the same financial year as the error was made should be treated as reclassification rather than a code correction.

128. If items of inventories were wrongly classified as NCAs in a previous year and have therefore been wrongly depreciated, the correcting entries will firstly be to write back the depreciation to the net operating cost section of the SOCNE and then to transfer the gross carrying amount from NCAs to RMC.

Transfers

Transfers Within the Department

129. Transfers of AUC (including capitalised development expenditure) typically take place within the DE&S TLB. AUC balances on TLB managed projects are transferred to the appropriate TLB on delivery into service. TLBs which acquire NCAs locally (i.e. one-off purchases) are to bring them onto the SOFP using the appropriate in-year capital additions codes. Each balance is to be transferred immediately, using the appropriate NCA clearing accounts, to the appropriate TLB for input on to an NCAR or to the owning PT in the case of Capital Spares

130. The DBS FAADMT is responsible for reconciling inter-management grouping accounts on a monthly basis and for highlighting and resolving imbalances. This identifies any NCAs not recorded in the accounts of the receiving TLB and allows them to be investigated and subsequently cleared.

131. NCAs in use should not generally be transferred within the Department.

Transactions Between Government Departments

132. The transfer of NCAs to another government department, except under a transfer of function or a merger of departments, should be treated as a normal commercial transaction - i.e. as a sale at fair value.

133. For NCAs, fair value should be based on market value (i.e. based on values of similar assets bought and sold in an open market) or at DRC.

134. If assets are to be transferred for no consideration, FMPA A&TM must be informed as HM Treasury will need to be consulted.

Disposals

135. In accordance with IFRS 5, NCAs which are held for sale should be valued at the lower of their carrying amount and their fair value less costs to sell. Any write-down of the asset should be recognised as an impairment in accordance with Part 1 Chapter 5 paragraph 62.

136. An asset is deemed to be held for sale if its carrying amount will be recovered principally through a sales transaction rather than through continuing use. For this to be the case, the sale must be highly probable and the asset (or group of assets) available for immediate sale in its/their present condition (subject only to terms that are usual for the sale of such assets).

137. For the sale to be highly probable the appropriate level of management (which will depend on the asset's value) must be committed to a plan for selling the asset/group of assets and an active programme to locate a buyer to complete the sale must be in place. The sale should be expected to complete within one year from the date on which the asset is classified as held for sale. If it becomes necessary to extend the sales completion timeframe beyond one year, the asset can still be classified as held for sale, provided that the delay is caused by events or circumstances beyond the Department's control and the Department can demonstrate its on-going commitment to sell the asset.

138. An NCA that is to be abandoned shall not be classified as held for sale. This is because the carrying amount will not be recovered principally through a sales transaction – examples include an asset under construction that is cancelled, NCAs that are closed rather than sold and an asset in service that is scrapped and the scrap proceeds are incidental. An NCA that has been temporarily taken out of use shall not be accounted for as if it has been abandoned. As an abandoned NCA is not classified as held for sale, the NCA should continue to be depreciated until the end of its useful life. It should be reviewed for impairment and any write-down of the asset should be recognised as an impairment in accordance with Part 1 Chapter 5 paragraph 62.

139. In accordance with IFRS 5, assets which are held for sale should be presented and disclosed separately within current assets in the SOFP. No further depreciation is charged on those assets.

140. The point of disposal is the point at which legal ownership or legal title to the NCA passes to a third party or when the asset is physically scrapped because it is surplus to requirements or beyond economic repair.

141. All losses on disposal of NCAs are charged to the SOCNE.

142. Profits on disposal are only netted off against expenditure in the SOCNE where they are no more than adjustments to depreciation (or amortisation) or to an impairment previously charged to the SOCNE. This is usually the appropriate treatment for depreciable NCAs which are revalued and for other assets originally acquired for the Department's own use which have been written down to fair value less costs to sell. Other profits on disposal of assets will be treated as income in the SOCNE.

143. Where a strategic decision is made to dispose of assets - i.e. one falling outside current disposal policy, any material effect this has on the SOCNE is reported as an exceptional item (with associated explanatory notes).

144. Refer to Part 2 Chapter 5 paragraph 24 for details on disposals of property and non-property NCAs.

Gifting

145. The Department sometimes makes gifts of public property to outside bodies. This effectively represents a waiver of the receipts due to the Defence budget and thus constitutes Defence expenditure.

146. Items for gifting need to be valued on the basis of open market value (OMV) or, in the rare instances where items have to be replaced, at DRC.

147. If the OMV (or DRC) is greater than the asset's carrying amount, the asset should be revalued following the accounting treatment set out in Part 1 Chapter 5 paragraph 52. However, if the OMV (or DRC) is less than the asset's carrying amount, it should be revalued by applying the accounting treatment for impairments described in Part 1 Chapter 5 paragraphs 62 to 63.

148. On gifting the asset, it should be removed from the NCAR/supply system with its carrying amount taken through the disposals account. This treatment will result in a loss on disposal being recognised in the SOCNE. Any Revaluation Reserve balances relating to the gifted asset should be released to the General Fund.

149. FMPA A&TM should be informed of any proposed gifting to ensure that any disclosure requirements in the Departmental Resource Accounts are met.

150. Refer to JSP 462 for further details on gifting policy and approval procedures.

Decommissioning

151. Decommissioning is the process through which an NCA is taken out of commission and brought to a state where it is available for unrestricted alternative use, with waste materials permanently and safely disposed of.

152. PTs must identify the cost of decommissioning NCAs and create a provision within their SOFP. In most cases decommissioning will not be required - for example, when disposing of motor vehicles.

153. Decommissioning work that the Department is obliged to undertake is provided for in full at the time that the environmental damage first takes place or the contamination occurs.

154. The provision is capitalised as an asset if the Department will derive economic benefit from it – e.g. the decommissioning provision which is recognised during the operational life of a submarine.

155. Detailed guidance on how to account for provisions for liabilities and charges is provided in Part 1 Chapter 8.

Disclosure

156. NCAs are disclosed in the accounts under the following sub-headings:

a. Land;

b. Buildings;

c. Dwellings;

d. Information technology;

e. Single use military equipment;

f. Plant and machinery;

g. Transport;

h. Assets under construction – SUME;

i. Assets under construction – Others.

157. Capital spares and GWMB are included within the appropriate category of tangible NCAs.

158. NCAs obtained under hire purchase, leasing and PFI arrangements have other disclosure requirements. For assets held under finance leases, the net amount should be disclosed by each sub-heading - for example, plant and equipment.

159. Separate disclosure is required for assets held for use in operating leases - i.e. where the Department is the lessor. The gross carrying amount of assets held for use in operating leases and the accumulated depreciation charges, which are included in the overall asset totals, should be disclosed by each asset sub-heading. Extensive disclosures are required for heritage assets. See Part 1 Chapter 5 paragraphs 243 to 248.

160. The fair value of assets funded by a donation (including donated assets) or by a government grant should be separately disclosed in the NCA note in the year in which the asset is acquired. Where the funder provides cash, rather than the physical assets, any

difference between the cash provided and the fair value of the assets acquired should also be disclosed.

161. The following SOCNE disclosure notes are required:

a. the depreciation charge for the period analysed between non-current tangible and intangible assets;

b. in-year depreciation on assets held under finance leases;

c. the aggregate finance charges in respect of finance leases;

d. the total of operating lease rentals, analysed between amounts payable for the hire of plant and machinery and amounts payable for other operating leases;

e. the aggregate amount of rentals receivable in respect of operating and finance leases.

162. For capital spares and GWMB:

a. capital spares depreciation and GWMB depreciation (net of releases of depreciation and backlog depreciation adjustments to the Revaluation Reserve) are to be included within depreciation and amortisation of tangible and intangible NCAs;

b. surpluses or deficits arising on disposal of capital spares and GWMB are to be included within the surplus/deficit arising on disposal of tangible NCAs.

c. write-off or write-on of capital spares and GWMB are to be included within NCAs written-off/written-on (net).

Specific Accounting Requirements

163. Specific aspects of NCA accounting requirements are explained below.

Assets Under Construction

164. AUC are not entered onto an NCAR but are usually tracked, on a project basis, via project account coding within the PT's General Ledger. They are included within NCAs on the SOFP. It is usual for contract costs to already reflect current costs and if this is the case, AUC balances are already at fair value. Therefore, indexation should not be applied to AUC where contract costs already include price inflation. The rationale for indexing or not indexing AUC must be retained to ensure that there is robust documentation available to the NAO. Further details are in Part 2 Chapter 5 paragraphs 40 to 47.

Capital Spares and Guided Weapons, Missiles and Bombs

165. Details on accounting for Capital Spares and Guided Weapons, Missiles and Bombs is in Part 2 Chapter 5 paragraphs 48 to 111.

Construction Contracts

166. Construction contract balances relate to commercial work undertaken on behalf of external customers and cover costs incurred on all production/repair and associated tasks. See Part 1 Chapter 3 paragraph 6.

Government Furnished Assets

167. Government Furnished Assets (GFA) is a term used to describe Departmentally funded and owned assets which are supplied to industry to support Departmental contracts. GFA is synonymous with the term Assets in Industry (AiI) and consists of four categories:

a. Government Furnished Equipment (GFE);

b. Government Furnished Facilities (GFF);

c. Government Furnished Information (GFI);

d. Government Furnished Resources (GFR).

Government Furnished Equipment

168. DE&S is responsible for reporting Contract Work Item (CWI) and Contract Support Item (CSI) NCAs, including capital spares and GWMB, on its SOFP.

169. The CWI and CSI NCAs are recorded on an NCAR or on inventory records as appropriate. The FAADMT is responsible, on behalf of DE&S, for accounting for the assets recorded on the NCAR, whilst the appropriate inventory holder is responsible for accounting for the CWIs and CSIs, including capital spares and GWMB held on inventory records.

170. The Project Team (PT) operating the project account to which Jigs Tools and Test Equipment (JTTE) and Contract Embodiment Items (CEIs) have been charged is responsible for maintaining proper records and accounting for the items.

171. The PT managing the project is responsible for maintaining appropriate records for CWIs and CSIs loaned to contractors.

172. The PT managing the project must ensure that:

a. contractors provide annual audit certificates for all items provided to them under the contract;

b. all necessary investigations are undertaken and appropriate accounting adjustments made;

c. the Asset Accounting Centre (AAC) is notified of all certificates received by the PT;

d. contractors provide DBS FAADMT (Manchester) with details of items held (balances and transactions) in accordance with DEFCON 694 (Accounting for Property of the Authority) – see Part 2 Chapter 5.

173. JTTE and CEIs provided to contractors to support current projects should be charged to project costs in the related project account. If they meet the capitalisation criteria, they should be capitalised as either development costs or AUC.

174. CWIs and CSIs issued to contractors in support of current projects are reported on the SOFP. The appropriate inventory holder records CWI and CSI inventory items within its SOFP.

175. Where equipment charged to one project is incorporated into a different project, the cost of the items is recorded in the latter's equipment project account.

176. Where equipment is removed from an existing NCA for incorporation into another NCA - for example, where the existing NCA is being disposed of or cannibalised - the value of the existing NCA is adjusted to reflect the cost of the equipment which has been removed. Similarly, the value of the NCA into which the equipment has been incorporated is increased by the cost of that equipment to the extent that capitalisation is appropriate.

177. More detailed definitions of GFA and their accounting treatment is covered in Part 2 Chapter 5 paragraphs 133 to 208.

Ancillary, Composite, Grouped Assets and Containers

178. The definitions and the accounting for ancillary, composite, grouped assets and containers are contained in Part 2 Chapter 5 paragraphs 112 to 132.

Leased Assets

179. A lease is an agreement whereby the lessor conveys to the Department the right to use an asset for an agreed period of time in return for an agreed level of payments.

180. IAS 17 lease accounting requirements are not confined to agreements which take the legal form of leases. Arrangements that do not take the legal form of a lease but which, under IFRIC 4, give the Department the right to control the use of the underlying asset in

return for a payment (or a series of payments) may be deemed to contain a lease if the following criteria are met:

a. fulfilling the arrangement depends on a specific asset or assets. The asset need not be explicitly identified by the contractual provisions of the arrangement. Instead, it may be implicitly specified because it is not economically feasible or practical for the supplier to fulfil the arrangement by using any alternative asset(s);

b. the arrangement conveys a right to control the use of the underlying asset, which is the case when any of the following conditions are met:

i. the Department has the ability or right to operate the asset or direct others to operate it while obtaining or controlling more than an insignificant amount of the output or other utility of the asset;

ii. the Department has the ability or right to control physical access to the asset while obtaining more than an insignificant amount of the output or other utility of the asset;

iii. there is only a remote possibility that parties other than the Department will take more than an insignificant amount of the output or other utility produced or generated by the asset during the term of the arrangement; and the price that the Department will pay for the output is neither contractually fixed per unit of output nor equal to the current market price at the time of delivery.

181. If an arrangement contains a lease, the Department should apply IAS 17, 'Leases' to the lease element of the arrangement. IFRIC 4 should be applied for all new contracts. FMPA A&TM are co-ordinating a review of existing contracts that have the potential to fall within the scope of IFRIC 4.

182. It has been agreed with the NAO that IFRIC 4 does not apply between the Department and its Trading Funds, as the Trading Funds' assets are already in the Public Sector and are therefore fully visible. However, IFRIC 4 would apply to Trading Fund accounts if they had an IFRIC 4 type arrangement with the private sector. Items leased to the Department may be held under either finance or operating leases.

183. A finance lease is one which transfers substantially all the risks and rewards of ownership of an asset to the lessee. Examples of situations which individually or in combination normally lead to a lease being classified as a finance lease are:

a. the present value of minimum lease payments is equal to substantially all the fair value of the leased asset;

b. the lease term is for the majority of the leased asset's economic life even if ownership is not transferred;

c. ownership is transferred to the lessee by the end of the lease term;

d. the arrangement contains a bargain purchase option making it reasonably certain at the inception of the lease that the option will be exercised;

e. the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

184. Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

a. if the lessee can cancel the lease and any losses suffered by the lessor as a result of the cancellation are borne by the lessee;

b. gains or losses generated by fluctuations in the fair value of the residual value fall to the lessee. For example, a rebate equal to most of the sales proceeds at the end of the lease);

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

185. An operating lease is a lease other than a finance lease. It does not transfer substantially all the risks and rewards of ownership.

186. At the inception of the lease, IAS 17 requires the land and buildings elements of a lease to be considered separately to enable them to be classified in their own right. The buildings element and the land element are classified as either a finance or an operating lease when measured against the situations and indicators of a finance lease described in Part 1 Chapter 5 paragraphs 183 and 184. In applying these situations and indicators to the land element, an important consideration is that land normally has an indefinite economic life.

187. Where leases of buildings are for only a small part of the useful life of the building and the lessee does not obtain the economic benefits of ownership arising, for example, from any increase in value, they should be accounted for as operating leases.

188. The Department may obtain use of NCAs under leasing arrangements. Items leased to the Department may be held under either a finance or an operating lease.

<u>Where the Department is the Lessee</u>

189. Where TLBs enter into a lease, they must consult FMPA A&TM for advice on its classification and accounting treatment. All leases with an annual charge of greater than £10,000 must be reviewed to determine their categorisation under IAS 17.

190. NCAs which the Department, as lessee, holds under a finance lease are capitalised as NCAs in accordance with the Departmental capitalisation threshold and recorded in the NCAR. They are subject to the same revaluation policies and accounted for in the same way as NCAs owned by the Department.

191. NCAs held under a finance lease are depreciated over the shorter of the lease period and the useful economic life of the asset. However, if there is reasonable certainty that the Department will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset.

192. At the inception of the lease, the NCA's value is equal to its fair value or, if lower, the present value of the minimum lease payments, which is calculated by discounting them at the interest rate implicit in the lease.

193. The minimum lease payments are the payments over the lease term that the Department is, or can be, required to make together with any costs guaranteed by the Department or by a party related to the Department but excluding contingent rent.

194. The Department may have an option to purchase the asset at a price that is expected to be below fair value at the date that the option becomes exercisable. If, at the inception of the lease, it is reasonably certain that the Department will exercise this option, the minimum lease payments should comprise the minimum payments payable over the lease term to the date on which it is anticipated that the purchase option will be exercised and the payment made.

195. The lease term is the non-cancellable period for which the Department has contracted to lease the asset together with any further terms which give the Department an option to continue to lease it, with or without further payment, provided that at the inception of the lease it is reasonably certain that the Department will exercise the option. For example, the Department may be reasonably certain to lease an asset beyond a break clause.

196. An 'obligation under finance lease' liability should also be created. This represents the capital element of the future lease payments. At the inception of the lease, this is the present value of the minimum lease payments, discounted at the interest rate implicit in the lease (and will equate to the related NCA entry).

197. In order to classify and account for a lease of land and buildings, the minimum lease payments are allocated between the land and building elements. This is calculated in proportion to the relative fair values of the leasehold interests in the separate land and buildings elements at the inception of the lease. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.

198. Payments made under finance leases are apportioned (in accordance with the leasing agreement) between reductions in the 'obligation under finance lease' liability and the finance charges which are expensed to the SOCNE.

199. Expenditure under operating leases is charged directly to the SOCNE in the period in which it is incurred.

Where the Department is the Lessor

200. NCAs which are owned by the Department but leased under a finance lease to a body outside the Departmental boundary should not be shown as NCAs within the Department's SOFP, as the risks and rewards of ownership of the assets have been transferred to the external body. The present value of the minimum lease payments due, which are calculated by discounting them at the interest rate implicit in the lease, should be accounted for as a receivable.

201. Payments received under finance leases are apportioned (in accordance with the leasing agreement) between reductions in the receivable balance in the SOFP and the finance charges which are credited to the SOCNE.

202. NCAs that are owned by the Department but which are leased to a body outside the Departmental boundary under an operating lease should be shown on the Department's SOFP as NCAs. These assets should be recorded in an NCAR.

203. Payments received under operating leases, excluding any service charges (for example, maintenance charges) should be credited to the SOCNE.

Historic Leaseholds

204. From 1 April 2001, historic leaseholds have been accounted for as operating or finance leases as appropriate.

Dilapidations

205. Many property leases include tenant repairing clauses. Such clauses typically require the tenant to return the property to the landlord at the end of the tenancy in a specified condition. The tenant will therefore have a legal obligation, arising from the terms of the lease agreement, to pay the costs of any dilapidations. Refer to Part 1 Chapter 8 for the accounting treatment.

Leasehold Improvements

206. Leasehold improvements relate to Departmental expenditure on making leased buildings suitable for occupation. The value of leasehold improvements can be capitalised if they meet the capitalisation criteria in Part 1 Chapter 5 paragraph 69. They should be depreciated over the shorter of the lease period and the useful economic life of the asset.

Public Private Partnership (PPP) Arrangements including Private Finance Initiative (PFI) Contracts

207. This section deals with the accounting treatment of PPP arrangements, including PFI contracts, that meet the definition of service concession arrangements contained in IFRIC 12, 'Service Concession Arrangements'.

208. To be within the scope of IFRIC 12, the service concession arrangement must contractually oblige the private sector operator to provide the services relating to the infrastructure to the public on behalf of the Department.

209. Contracts that do not involve the transfer or creation of an infrastructure asset for the purpose of the contract fall outside the scope of IFRIC 12, as do arrangements that do not involve the delivery of services to the public.

210. Generic examples of infrastructure for public services are roads; bridges; tunnels; prisons; hospitals; airports; water distribution facilities; telecommunication networks; permanent installations for military etc. operations; and NCAs used for administrative purposes to deliver services to the public.

211. Each PPP arrangement must be assessed on its own merits to establish whether the arrangement creates infrastructure in the sense of IFRIC 12. In the widest sense, infrastructure covers the Department's strategic assets (or groups of assets) and the means by which the Department carries out its business. In this sense all the Department's service concession agreements are, in principle, capable of being infrastructure. For example, assets such as vehicle fleets could validly be seen as infrastructure given their size and role in delivering Departmental outputs.

212. Where PPP and PFI contracts do not fall within the scope of IFRIC 12, the arrangement should be assessed to establish whether it contains a lease under IFRIC 4 in accordance with Part 1 Chapter 5 paragraph 180. If it does contain a lease, IAS 17 should be applied to determine whether the lease is a finance or an operating lease and it should be accounted for accordingly (see Part 1 Chapter 5 paragraphs 189 to 203). Where the arrangement does not contain a lease, the expenditure will be recognised as it falls due.

213. There may be rare cases where some assets of a PPP contract meet the definition of infrastructure and some do not. A split SOFP treatment (i.e. some assets on the Department's SOFP and some off the Department's SOFP) may be required in these circumstances.

214. IFRIC 12 applies to:

a. arrangements where the infrastructure is used for its entire useful life;

b. infrastructure that the operator constructs or acquires from a third party; and

c. infrastructure that the Department provides to the operator for the purpose of the concession.

215. Where there is infrastructure, whether previously owned by the contractor or the Department or constructed or acquired from a third party for the purpose of the service concession arrangement, and the Department controls:

a. or regulates which services the operator must provide with the infrastructure; to whom it must provide them; and at what price; and

b. through beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the term of the arrangement (or there is no residual interest), then, from the Department's perspective, the PPP arrangement or PFI contract is a service concession within the meaning of IFRIC 12.

216. The residual interest in the infrastructure is the estimated value of the infrastructure as if it were already of the age and in the condition expected at the end of the arrangement. Where the Department has the option to purchase the asset, at whatever price, it will mean that the Department has control over the residual interest. In addition, the overall value of the residual value should be borne in mind when reviewing the substance of the agreement.

217. Where the infrastructure asset is used for its entire life, and there is little or no residual interest, the arrangement falls within scope of IFRIC 12 if the Department controls or regulates the services as described in the first condition.

218. Significant residual interest will exist where the Department is contractually required to purchase the infrastructure asset at the end of the term of the arrangement.

219. In determining the applicability of the first condition, non-substantive features (such as price capping that would only apply in remote circumstances) should be ignored and the substance of the arrangement considered.

220. The Department should recognise the infrastructure as an NCA and value it in the same way as other NCAs of that generic type. The asset should be recognised where:

a. it is probable that future economic benefits associated with the asset will flow to the Department; and

b. the cost of the asset can be measure reliably.

221. The Department should consider the asset recognition criteria above, together with the specific terms and conditions of the binding arrangement, when determining whether to recognise the service concession asset during the period in which the asset is constructed or developed. If the asset recognition criteria have been met, an Asset Under Construction service concession asset and associated liability should be recognised. If not and the Department makes contributions to the operator in advance of the asset coming into use, the Department should account for those payments as prepayments.

222. Additional guidance can be found in Part 2 Chapter 5 which covers accounting for assets transferred to the Private Sector Operator and also accounting for residual interests.

223. Part 1 Chapter 7 paragraph 85 contains the accounting treatment for Contracting for Availability contracts (sometimes referred to as Contractor Logistic Support contracts).

Heritage Assets

<u>Definition</u>

224. A heritage asset is a tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture.

225. Heritage assets are those which are preserved in trust for future generations because of their cultural, environmental or historical associations. They are held by the Department to meet the overall objective of maintaining the heritage.

226. Heritage assets include: historical buildings: archaeological sites; military and scientific equipment of historical importance: museum and gallery collections; and works of art.

227. Heritage assets display the following attributes:

a. their value to the Government and to the public in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value derived from a market price;

b. established custom and, in many cases primary statute and trustee obligations, impose prohibitions or severe restrictions on disposal by sale;

c. they are often irreplaceable and their value may increase over time, even if their physical condition deteriorates;

d. they may require significant maintenance expenditure to enable them to be enjoyed by future generations;

e. their life may be measured in hundreds of years.

228. Heritage assets are categorised as either operational or non-operational:

a. non-operational heritage assets are those which are held primarily for the purpose described in Part 1 Chapter 5 paragraph 225. For example, archaeological sites.

b. operational heritage assets are those which, in addition to being held for their characteristics as part of the nation’s heritage, are also used by the Department for other activities or to provide other services. For example, historical buildings used as office accommodation.

229. Antiques and other works of art which are held by the Department (and lie outside the main collections) will only meet the definition of an heritage asset if they fulfil the criteria in Part 1 Chapter 5 paragraph 224. Those which fail the heritage asset definition should be capitalised using the same methodologies as for non-heritage assets.

230. The Department should attest annually to the on-going heritage credentials of its heritage assets.

Recognition and Measurement

231. Operational heritage assets should be valued using the same valuation methodologies as for other assets of that general type (for example, buildings).

232. Non-operational heritage assets should be valued subject to the requirements set out in Part 1 Chapter 5 paragraphs 233 to 238.

233. All NCAs (whether non-heritage or heritage) should be valued at fair value. However, where, in exceptional cases, it is not practicable to obtain a fair value, the heritage assets may be reported at historical cost.

234. Where information is available on the cost or value of heritage assets (both operational and non-operational):

a. they should be presented in the SOFP separately from other tangible assets;

b. the SOFP or the notes to the accounts should separately identify classes of heritage assets being reported at cost and those at valuation; and

c. changes in the valuation should be recognised in the Other Comprehensive Net Expenditure section of the SOCNE, apart from impairment losses that should be recognised in the same way as for non-heritage assets in accordance with Part 1 Chapter 5 paragraphs 57 to 67.

235. Where assets have previously been capitalised or recently purchased, information on their cost or value will be available. However, where this information is not available and cannot be obtained at a cost commensurate with the benefits to users of the Annual Accounts, the assets will not be recognised in the SOFP and the disclosures required in Part 1 Chapter 5 paragraphs 243 to 248 should be made.

236. Valuations may be made by any method that is appropriate and relevant.

237. There is no requirement for valuations to be carried out or verified by external valuers nor is there any prescribed minimum period between valuations. However, where heritage assets are reported at valuation, the carrying amount should be reviewed sufficiently often to ensure that the valuations remain current.

238. Where the Department transfers non-operational heritage assets to an NDPB under Managing Public Money gifting rules, a best estimate of their market value should be applied – for example, by using any available insurance or auction sales values. Obtaining a professional valuation may not be viewed as value for money in which case alternative sources should be sought.

Depreciation and Impairment

239. Heritage assets which have an indefinite life are not depreciated.

240. The carrying amount of an heritage asset should be reviewed where there is evidence of impairment - for example, where it has suffered physical deterioration or breakage or new doubts arise as to its authenticity.

241. Any impairment recognised should follow the policy for non-heritage assets. (See Part 1 Chapter 5 paragraphs 57 to 67).

Donations

242. The value of donated heritage assets should be credited to income unless a condition is imposed by the funder in which case the income is deferred (see Part 1 Chapter 2 paragraphs 17 and 18). Where, in exceptional cases, it is not possible to obtain a valuation for a donated heritage asset, the disclosures required in Part 1 Chapter 5 paragraph 247 must be applied.

Disclosures

243. The disclosures required for all heritage assets are:

a. the Department's Annual Accounts should contain an indication of the nature and scale of the heritage assets it holds;

b. the Annual Accounts should set out the Department's policy for the acquisition, preservation, management and disposal of heritage assets. This should include a description of the records maintained by the Department for its collection of heritage assets and also information on the extent to which access to the assets is permitted. This information can alternatively be provided in a document that is cross-referenced to the Annual Accounts;

c. the accounting policies adopted for the Department's holding of heritage assets should be stated, including details of the measurement bases used;

d. for heritage assets that are not reported in the SOFP, the explanation for not doing so should be provided and the notes to the Annual Accounts should explain the significance and nature of the assets not reported in the SOFP;

e. the disclosures relating to assets that are not reported in the SOFP should aim to ensure that, when read in the context of information about capitalised assets, the Annual Accounts provides useful and relevant information about the Department's overall holding of heritage assets.

244. Where heritage assets are reported in the SOFP, the following should be disclosed:

a. the carrying amount of heritage assets at the beginning of the financial period and at the SOFP reporting date, including an analysis between those classes or groups of heritage assets that are reported at cost and those that are reported at valuation; and

b. where assets are reported at valuation, sufficient information to assist in an understanding of the valuations being reported and their significance. This should include:

i. the date of the valuation;

ii. the methods used to produce the valuation;

iii. whether the valuation was carried out by external valuers and, where this is the case, the valuer's name and professional qualification, if any; and

iv. any significant limitations on the valuation - for example, where an asset has a particular provenance, the effect of which is not fully captured by valuation.

245. Information that is available to the Department and is helpful in assessing the value of those heritage assets that are not reported in the Department's SOFP should be disclosed.

246. The Annual Accounts should contain a summary of transactions relating to heritage assets. This should provide separate disclosure (i.e. for assets that are reported in the SOFP and those that are not) of the following information for the accounting period and for each of the previous 4 accounting periods:

a. the cost of acquisitions of heritage assets;

b. the value of heritage assets acquired by donation;

c. the carrying amount of heritage assets disposed of in the period and the proceeds received; and

d. any impairment recognised in the period.

247. Where, exceptionally, it is not practicable to obtain a valuation of heritage assets acquired by donation, the reason should be given. Disclosures should also be provided on the nature and extent of significant donations of heritage assets.

248. The disclosures required in Part 1 Chapter 5 paragraphs 243 to 248 may be presented in aggregate for groups or classes of heritage assets, provided that this aggregation does not obscure significant information. Separate disclosures should be provided for assets reported at cost and those reported at valuation.

Donated Assets

249. Donated assets are those which have been donated to the Department. Assets can be donated by a third party either by gifting the assets or gifting funds with which to purchase the assets.

250. To qualify as a donated asset, no consideration can be given in return.

251. Assets that do not pass this test should be accounted for in the same way as any other NCA.

252. The Department may give or receive assets to/from another public sector body (including public sector bodies outside of the Departmental boundary) for no consideration. Assets acquired in this way will normally be recognised in accordance with Part 1 Chapter 2 paragraphs 23 to 28. FMPA A&TM should be consulted before entering into such a transaction, as the proposed transaction will need to be discussed with HM Treasury.

253. The accounting treatment for donated assets is contained in Part 1 Chapter 2 paragraphs 12 to 22.

Assets Funded by Grants

254. Grants received can come from government and inter-governmental agencies and similar bodies, whether local, national or international, including the European Union (EU).

255. The accounting treatment for grant funded assets is contained in Part 1 Chapter 2 paragraphs 23 to 28.

Guidance

256. Guidance on categorisation of tangible NCAs, disposals, AUC, capital spares and GWMB, ancillary assets, composite assets, grouped assets, containers, Government Furnished Assets, NCA non-financial data standards and accounting for PPP arrangements (including PFI contracts) is given in Part 2.

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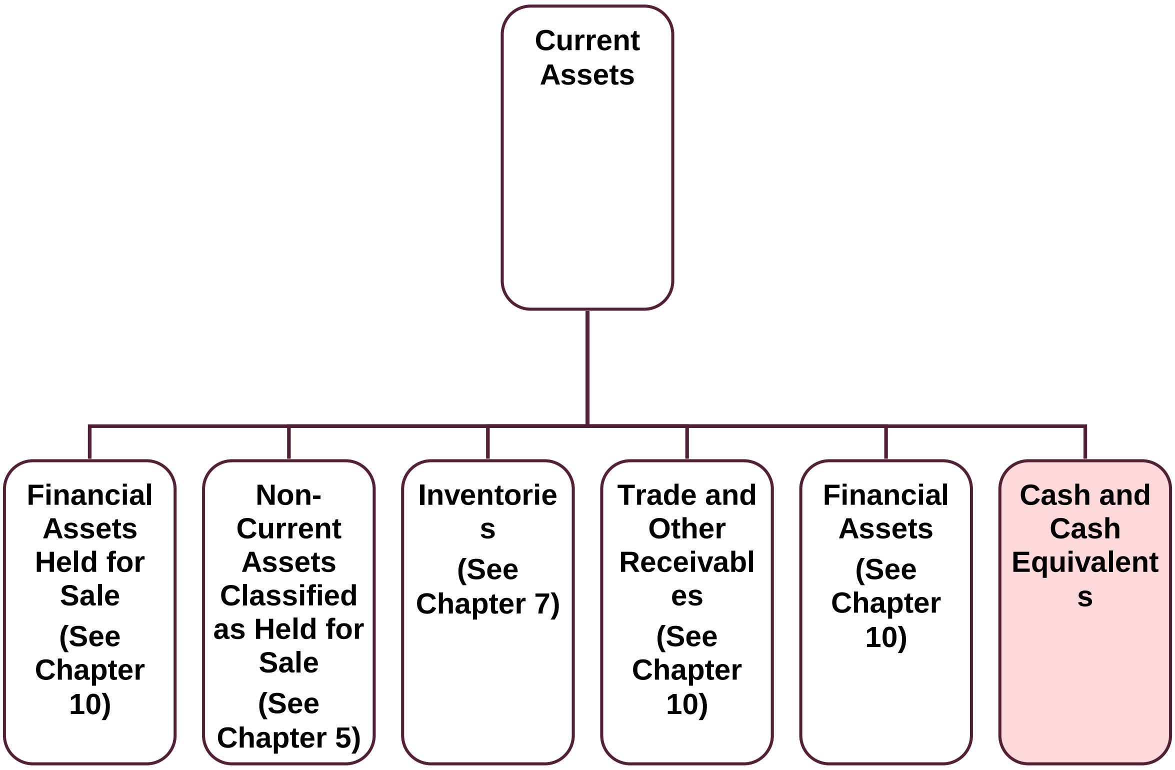
6 Cash and Cash Equivalents



Introduction

1. This chapter sets out the policy for cash and cash equivalents and explains how the Department manages and controls its bank accounts. It also outlines how the Department draws down its funding within the limits of the Net Cash Requirement.

Specific Responsibilities

2. Specific responsibilities are listed below.

FMPA Accounting and Treasury Management (FMPA A&TM)

3. FMPA A&TM is responsible for:

a. setting overall control policies and procedures and monitoring compliance with those controls, at all levels, including TLBs;

b. setting and periodically reviewing target levels of bank balances;

c. reviewing funding requirements for central commercial bank accounts;

d. monitoring actual balances against target levels;

e. reporting on TLB cashflow forecasting performance.

TLBs

4. TLBs are responsible for accounting for:

a. all cash and cash equivalents transactions associated with bank account balances reported on their Statement of Financial Position (SOFP);

b. preparing and monitoring monthly cash flow projections for FMPA A&TM to allow the monthly draw down of Supply from the Consolidated Fund to be calculated. TLBs are also responsible for explaining variations from forecasts.

Definitions

5. Cash and cash equivalents are defined as follows:

a. cash comprises cash on hand and demand deposits (repayable on demand) with any commercial bank or other financial institution. It includes cash in hand; gold coins and deposits denominated in foreign currencies after allowing for unpresented payments and uncleared deposits. Cash in hand (petty cash) includes postal orders and stamps;

b. cash equivalents comprise short-term, highly liquid investments that are readily convertible to known amounts of cash with no significant risk of the value changing.

Bank Account Management

6. To ensure that funds are available to TLBs at the correct time:

a. the Department's cash flows are forecast and managed to minimise unutilised cash and cash equivalents balances and to control foreign currency risks;

b. bank charges and interest costs are minimised;

c. effective control policies and procedures are exercised to ensure that the movement of funds can be accounted for.

Central Bank Account Management

7. Group account balances with commercial banks (designated in both Sterling and foreign currencies) are funded from the main Departmental Supply bank account in the Government Banking Service (GBS). In practice, most UK-based bank accounts will be held with the GBS.

8. The principle payment organisations within the Department are DBS, WPB and DBS - AFPS. These have authority to issue Payable Orders and Bankers' Automated Clearance Services (BACS)/Clearing House Automated Payment System (CHAPS) payments which are encashed against their individual GBS accounts.

9. Supply is drawn down monthly from the Consolidated Fund in accordance with TLB forecasts into the main Departmental Supply bank account by FMPA A&TM who also funds the GBS bank accounts of the principle payment organisations on a monthly basis. In addition:

a. FMPA A&TM and the principle payment organisations record the transactions and reconcile all their own bank accounts;

b. FMPA A&TM manages funds and maintains optimum balances on all central bank accounts.

10. Bank charges on all bank accounts are retained in the owning TLB.

Local Cash and Cash Equivalents Account Management

11. TLBs must ensure that:

a. their set procedures align with the policies and procedures detailed in JSP 891;

b. bank reconciliations are carried out regularly in compliance with JSP 891;

c. all bank-related control accounts are reconciled at least once a month;

d. internet access to bank accounts complies with security guidelines and the policies set out in JSP891;

e. accounting records correctly reflect all bank accounts within their control and that complete audit trails are maintained and available;

f. ensure that bank accounts are used solely for the purpose for which they were originally authorised and opened;

g. all bank account postings, which give rise to Statement Of Comprehensive Net

Expenditure (SOCNE) charges or credits and therefore affect the Departmental outturn are made in the relevant financial year;

h. bank accounts specifically opened for exercises/deployments are properly controlled and cleared immediately on completion of the associated activity.

12. Where interest is earned on a bank account holding non-Exchequer funds – i.e. third party funds – and it has been agreed that the interest can be retained by the Department, the sums have to be surrendered to the Consolidated Fund. TLBs should transfer the interest to the CFER control account in the FMPA A&TM accounts.

Accounting and Disclosure

13. Cash and cash equivalents balances are included in the Annual Accounts as current assets.

14. Payments made from bank accounts are to be accounted for when the relevant payable instruments (cheques, POs, BACS/CHAPS) are issued, not when they are presented. This is known as the cashbook position and means that, for accounting purposes, the balances are made up of:

a. the balances shown on the bank statements; less

b. the value of any payable instruments issued but not yet presented for payment; plus

c. deposits banked but not yet reflected on the bank statement.

15. HM Treasury policy is for bank overdrafts to be accounted for in the SOFP as a payable and not as a negative cash balance. Balances on Offset Group Bank Accounts should be recorded as negative cash balances, as the net overall position is always a positive balance on all such accounts.

16. Balances in the main GBS bank accounts are maintained in a net positive position at year end after allowing for large values of unrepresented payable instruments, if necessary.

17. The notes to the accounts show balances with accounts within the GBS and Commercial banks. Further analysis shows Exchequer Funds and other balances held on behalf of third parties.

18. Amounts drawn from the Consolidated Fund at year-end in excess of the Net Cash Requirement should be disclosed as a year-end liability after adjusting for any Excess Appropriations in Aid. This liability will be offset in the subsequent year when the previous year’s surplus drawing will deemed to have been repaid and replaced by a matching issue from the current year’s provision. There may, by exception, be circumstances where after adjusting for any Excess Appropriations in Aid, insufficient Supply has been drawn down.

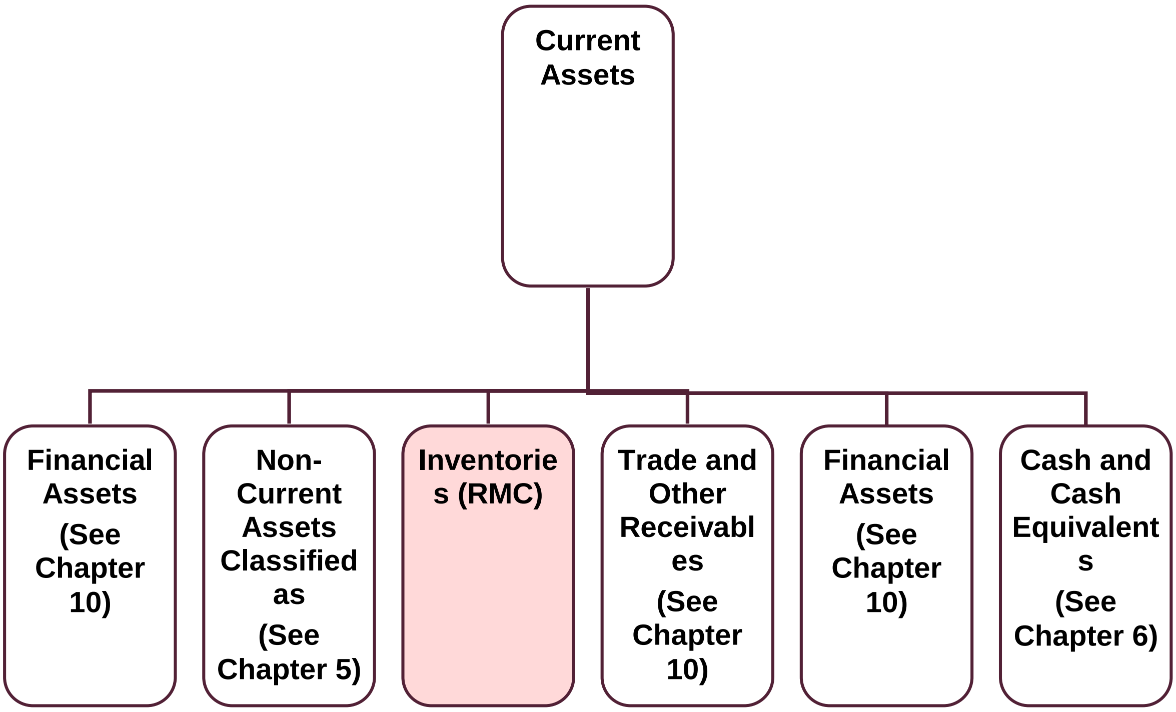
Presuming Supply is still available, a receivable will be set up and recovered in the following year.

19. The amount due to the Consolidated Fund for cash drawn but not spent at year end should be disclosed in a note to the accounts. This should be separate from other payables and also separate from any amount which, when received, is due to be surrendered to the Consolidated Fund.

Guidance

20. There is no guidance on accounting for cash and cash equivalents in Part 2.

7 Inventories (Raw Materials and Consumables)

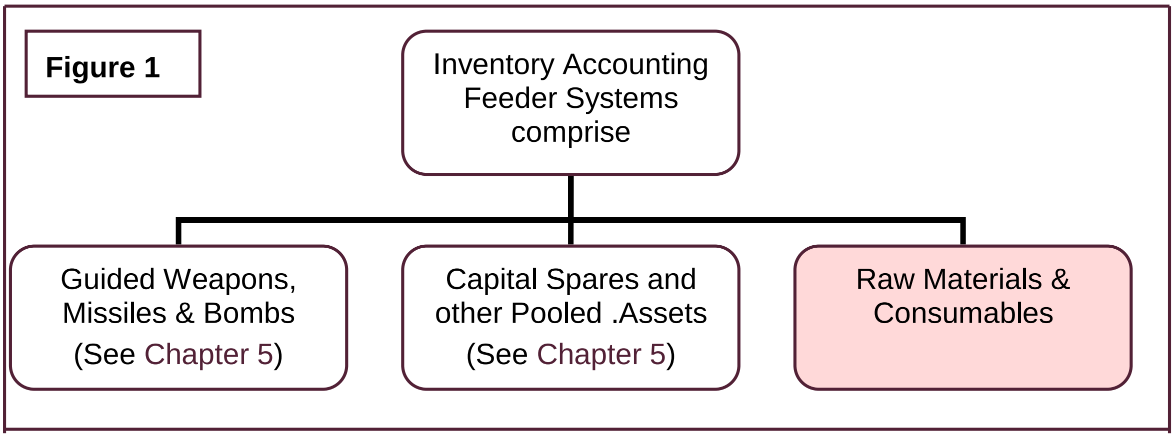


Introduction

1. This chapter sets out the accounting requirements for inventories which, for financial accounting purposes, comprise Raw Materials and Consumables (RMC). See Figure 1.

2. In the financial accounting context, Capital Spares and Guided Weapons, Missiles and Bombs (GWMB) are defined as Non-Current Assets (NCAs). Their accounting treatment is covered in Part 1 Chapter 5.

3. The term ‘inventory’ covers materiel (i.e. Capital Spares, GWMB and RMC) accounted for in the MoD Statement of Financial Position (SoFP) and held on a MoD supply system or by inventory partners under a contractual arrangement. Materiel accounting rules are covered in the Defence Logistics Supply Chain Manual, JSP 886.



Specific Responsibilities

4. Specific responsibilities are listed below.

Inventory Accounting Team

5. The Inventory Accounting Enabling Team (IAET) is responsible for ensuring that financial accounting policy is applied consistently.

Categorisation

6. The term 'inventory' covers materiel (which can be capital spares, inventory or RMC) which is held on a supply system. Figure 2 shows how capital spares and RMC are categorised. The accounting treatment for Capital Spares and GWMB is covered in Part 1 Chapter 5 and Part 2 Chapter 5.

7. Raw materials are purchased for conversion and incorporation into NCAs. Consumables are not repairable and consist of items such as ammunition, fuel and support items (for example - hand tools). The inventory category analysis is shown in Part 2 Chapter 7 paragraph 2.

Ownership and Inter- Departmental Boundaries

8. Departmental ownership of items is recognised at the point of acquisition – i.e. when they are delivered to a storage depot, front line unit or a contractor. Boundaries must be established to ensure that TLBs capture and record balances but avoid any double-counting.

Materiality

9. Ready-use items outside DE&S tend to be local purchases by Front Line Commands. Although their value may not be material, in marginal cases it should be disclosed within the RMC balance.

10. Guidance on materiality in relation to ownership and how to treat various categories of RMC is summarised in Part 2 Chapter 7 paragraph 4.

Valuation

11. Items are valued at the lower of current cost (or, if not materially different, historic cost) and Net Realisable Value (NRV).

12. Consistent valuation across the Department is maintained through the operation of a single pricing record which is maintained in the Integrated Stock Ownership and Pricing System (ISOPS). Only one price is recorded for an individual item on a price record at any one time.

13. Items are recorded at their Basic Material Price (BMP) which is determined by:

a. the most up to date contract price;

b. the latest value obtained from a running contract price list;

c. the best technical valuation for a materiel conditioned 'A1' item available from contractors, MOD engineers or professional commercial valuers.

14. Prices entered on to ISOPs that are more than 12 months old are adjusted for inflation. Prices over 5 years old must be revalued by one of the methods in the preceding paragraph.

15. The relevant project, commodity or equipment support manager (normally a PT) will identify the circumstances in which NRV should be applied – one example being where items have been damaged or are not expected to be used or sold in the ordinary course of business.

16. Contract embodiment items, when they come off the shelf and for whatever purpose are considered as being consumed.

Definitions

17. An obsolete item is an item for which there is no further service use, either because it no longer meets the purpose for which it was acquired or because requirements have changed.

18. A defective item is an item which cannot be repaired because it is faulty, has been damaged or has deteriorated.

19. A surplus item is an item which exceeds estimated requirements or authorised holdings.

Cost of Purchase

20. The cost of purchase is defined as the purchase price and/or cost of conversion net of trade discounts or other rebates and subsidies. It includes the addition of packaging, carriage, customs duties and other expenses which are incidental to acquisition and can be identified to individual items or are specified in individual purchase contracts. Where applicable, costs will be VAT inclusive.

21. Guidance on accounting for development costs - for example, contractors' design, licensing, tooling and testing of RMC, can be found in Part 2 Chapter 4 paragraphs 24 to 32.

Cost of Conversion

22. Cost of conversion comprises direct materials, labour and expenses and other attributable overheads (including irrecoverable VAT). Where work is carried out by an external contractor, cost of conversion is represented by the invoiced cost net of any avoidable abnormal conversion costs.

23. Cost of conversion results in a revised valuation for items which have undergone material modification, enhancement or conversion.

Current Cost

24. Current cost is defined as the expenditure which would be incurred in manufacturing or acquiring an item of materiel at a current date. It represents the cumulative revaluation of items using latest cost of acquisition or indexation and applies to items expected to be used or sold in the ordinary course of business

25. Where supply system balances are not material in value or the items are consumed and replaced at frequent intervals, it is acceptable to value them at historical cost, as this will be sufficiently close to their value to the business. There is also unlikely to be any material difference between the two valuations.

Net Realisable Value

26. NRV is defined as the estimated disposal sales value of an item of materiel not expected to be used or sold in the ordinary course of business – for example, to reflect a change in demand or a movement in market conditions. Where appropriate, an NRV valuation also applies to RMC held for the manufacture of or incorporation into goods.

27. The estimated disposal value may be nil or scrap value. Any costs which are incidental to the sale (such as agent's fees) and can be identified to individual items or sales contracts are deducted from the sales proceeds on a net receipt basis. Disposal costs which are charged separately are reflected in the calculation of the surplus or deficit on disposal and reported in the SOCNE.

28. NRV takes into account the usage and condition of items. This typically covers: age: physical deterioration; serviceability; transaction history; and future frequency of issue or sales demand. Items valued at NRV should be identified for disposal.

Impairments

29. Financial impairments for RMC are created by assessing the quantity of a particular item which is not expected to be used or sold in the ordinary course of business. All assumptions made in determining the estimated impairments should be documented and reviewed at the end of each financial year.

30. Impairments are also created for munitions and shelf-lifed items to reduce their value over their estimated useful economic life - for example, to adjust valuations to reflect NRV. Where the usage of life of type (lifetime) buys is expected to be limited, impairment may commence at the start of the estimated useful economic life or at any time from acquisition to disposal. In certain circumstances this also applies to war maintenance reserves.

31. Impairments should only be created where there is sufficient certainty that the condition requiring the impairment will materialise. General impairments are not permitted (for example, for physical losses and stocktaking adjustments).

32. An RMC valuation impairment reduces an item’s value to NRV. The impairment is offset against the gross carrying amount. The value on individual price records and price status identification remains at current cost. The impairment is applied to surplus, unserviceable, defective and obsolete items as follows:

a. excess items. An RMC valuation impairment for surplus items is created for the quantity of items which are not expected to be used or sold in the ordinary course of business.;

b. defective and obsolete items. An RMC valuation impairment is made to write down the valuation for the total quantity of defective and obsolete items;

c. obsolescent items, i.e. items which are still in use but no longer commercially available continue to be valued at current cost unless classed as surplus or defective. No impairment is made against an obsolescent item expected to be used or sold in the ordinary course of business. This is unless its use is expected to be limited from the outset, in which case a lifetime impairment can be made. An item is valued at current cost, even if it is becoming obsolete, if there is a reasonable expectation that it will be used.

33. Irrespective of whether an impairment has been made, issues (other than to disposal) will be made at the full current cost . The impairment is released to the SOCNE on disposal.

34. NRV is assessed separately for each item. Individual valuation impairments and status identification changes are made as they arise. Where this is impracticable, the

impairment can be made by applying a certain percentage reduction - for example, on a stores range basis. Exceptionally, where a professional assessment of the aggregated estimated sales proceeds from a range of items declared for disposal is appropriate, an aggregate impairment can be made by applying an adjustment factor derived from the composite NRV valuation. The basis of the assessment is documented.

35. RMC valuation impairments are reported in the appropriate RMC valuation impairment account and offset against the gross carrying amount. These accounts are maintained separately from the RMC write-off accounts for physical RMC losses and stocktaking adjustments.

Price Records

36. The BMP for individual items is recorded on ISOPS. Where practicable, direct interfaces from principal RMC systems to the CPRs are established to ensure that pricing is consistent across the Department. Local price databases, which are maintained independently, have no effect on the financial accounts and must therefore be regularly updated against the Central Pricing Record currently maintained on ISOPS. Further details can be found in JSP 886 Volume 2, Part 6.

Valuation Summary

37. A summary of how valuation policy is applied is set out in Figure 2 .

Figure 2

Status of items	Basis of valuation	Price Status (supply system)	Impairment
Expected to be used/sold (non-life of type buy).	CC	CC	None.
Expected to be used/sold (life of type buy).	CC	CC	Surplus impairment (calculated on CC less estimated net realisable value). Offset against the SOFP valuation.
RMC - excess (i.e. surplus and defective).	NRV	NRV	Impairment for relevant quantity of excess. Offset against the SOFP valuation.
Obsolete.	NRV	NRV	Impairment for total quantity of obsolete items. The SOFP valuation is written-down to net realisable value.

Revaluation

38. Revaluation updates the value of an individual item through price supersession, indexation or other assessment. Revaluation to current cost is undertaken on an individual item basis and at least annually. Appropriate revaluation reserves are maintained. Consistency of valuation across the Department is maintained through reference to ISOPS and local price databases.

Periodicity

39. Where appropriate, periodic revaluation is undertaken more frequently than annually - for example, where prices for certain items are subject to short-term material fluctuations. Price supersession (i.e. price update) takes place at the time the item is purchased or acquired. Periodic revaluation is carried out on fixed dates or effective dates. for example, contract revisions.

Price Supersession

40. For an item that has been purchased or acquired since the last price update or periodic revaluation, the latest re-provisioning price (either at the time of ordering if the price is known or when subsequently invoiced) supersedes the existing price record. However, this should not be done if would distort the total value of the items – for example, in the case of one-off purchases to meet critical supply shortages.

41. Where there has been no price supersession, annual revaluation is made through indexation, reference to price lists, revised contracts, or through a professional valuation assessment. Items subject to recurring indexation are revalidated against current price lists or, in the absence of price lists, by professional valuation assessment every 5 years.

42. Price changes reflected in a contract revision are taken into account during periodic revaluation, provided that the contract is in force at that time. Periodic revaluation may be undertaken at the effective date of the contract. Price supersession will take place at the point at which an item is next acquired, unless this has been preceded by periodic revaluation in line with the revised contract.

43. Where price supersession is deemed inappropriate – for example, for one-off buys or due to short term currency fluctuations, the difference between the total cost of the items purchased and the total cost calculated using the existing price is reported as a purchase price variance in the purchase price variance account. The balance on the purchase price variance account is released in full to the SOCNE at the accounting period end, subject to any outstanding price investigations for which variances will be carried forward. Material purchase price variances are reported as exceptional items.

44. Revaluation of internally manufactured items, which include raw materials and other costs of conversion, may require more complex methodologies, for example, weighted indexation.

45. When items are declared obsolete, revaluation is suspended.

46. Where the cost of an item includes irrecoverable VAT, a change in the rate of VAT is taken into account during revaluation.

RMC Revaluation Reserve

47. Revaluation adjustments are reported in the appropriate Revaluation Reserve account. The balance on the Revaluation Reserve account reflects the unrealised elements of the cumulative revaluation adjustments. When items are issued for use, consumption, sale, write-off, disposal or permanent diminution in value (for example, to NRV) the associated balance in the Revaluation Reserve account is realised and released to the General Fund. See Part 2 Chapter 5 paragraphs 71 and 72 .

Consumption

48. The physical holder of the items is the custodian of the RMC. However, it is the owner who makes the decisions about acquisition, retention and disposal. The end user is the consumer who is also responsible for accounting for small value articles in use (for example, hand tools) which are regarded as consumed on issue. When items of RMC are consumed, the amount is charged to the SOCNE of the consuming TLB.

49. DE&S purchases RMC on behalf of Front Line Commands (FLCs). Items are considered to be consumed on issue to the FLC unless a material amount (for example, imprest or buffer RMC) remains, in which case the FLC credits the SOCNE and debits the SOFP. Where this is the case the FLC must reverse those entries as the material holding reduces on consumption.

Issues and Items in Transit

50. Issues are accounted for by the relevant owner on the appropriate inventory system at the point of:

a. issue to a different owner within the same TLB;

b. issue by one TLB and receipt by another;

c. issue for use or consumption by the end user;

d. transfer on a feeder system;

e. loan (which is rare);

f. sale;

g. write-off or disposal.

51. Internal Departmental issues are made at the current recorded price on the relevant price record.

52. In accordance with the policy set out in JSP 462, issues which are external to the Department (for example, to commercial customers, Other Government Departments and Trading Fund Agencies) include a charge to recover appropriate overheads (normally by percentage addition).

Treatment

53. Once an owner has issued items of RMC, the accounting treatment is as follows:

a. the items are reported in the end user's SOCNE as consumed;

b. the items are transferred to a different owner within the same TLB. The items continue to be reported in the new owner's SOFP;

c. the items are transferred to an owner in another TLB through GMG accounts. The items are reported on the new owner's SOFP;

d. the items are loaned. The items continue to be reported in the owner's SOFP.

54. Issues are made at basic material price (BMP), including VAT, if appropriate. Sales (including repayment issues) are priced at BMP with an addition to recover applicable overheads (as defined in Departmental repayment pricing procedures). The difference is reported in the appropriate SOCNE as a surplus on disposal of RMC.

55. RMC that are either consumed or are in the process of being used up, or which are otherwise regarded as consumed on issue, are reported as consumption in the SOCNE.

56. Items in transit are reported in the balances of the supplying owner up to the point of receipt by the end user or receiving owner. They must remain on the owner's account. PTs are responsible for making the relevant systems adjustment or, if this is not possible, for raising a manual journal. Issuing PTs and receiving owners should liaise closely to ensure that corresponding journals are posted in the same accounting period.

Transfers

57. Items may be transferred within or between TLBs.

Treatment

58. When items are issued from one BLB to another BLB within the same TLB, they continue to be reported in the issuing BLB's SOFP.

59. When items are transferred between TLBs, the new owning TLB reports them on its SOFP. The carrying amount, accumulated impairment and associated element of reserves are individually transferred but should be reviewed to see that they are still appropriate.

60. When items are procured by a purchaser who is not the owner, they should be physically transferred to the owner. In such cases, an inter-management grouping transfer is made to reflect the payment made by the purchaser for items delivered directly to the owner or the transfer from the purchaser to the owner if a physical transfer is involved. The only exception is where they are directly procured by the FLC for immediate consumption.

61. All transfers between TLBs are reconciled at the period end.

Receipts

62. Receipts are accounted for by the relevant owner on the appropriate RMC system. This may be: at the point of acquisition; when legal title transfers from a third party; when internally manufactured items are brought on charge; when items are returned; when items transfer between TLBs; and when spares are cannibalised or salvaged from other assets.

63. The point of receipt occurs on delivery, i.e. when items are brought on charge to the relevant RMC system, which may be in advance of formal acceptance. When items are received into non-Departmental locations, the Department accounts for them from the point at which it receives notification from the custodian.

64. Where items are purchased on behalf of another owner, an appropriate inter-management grouping transfer is made by the supplying TLB to the receiving TLB to enable the items to be recorded on the new owner's SOFP.

Returns (Other than Returns to the Manufacturer)

65. Items returned from a consuming TLB to a custodian/owning TLB are accounted for in the same way as receipts. Returns may occur as a result of items having become obsolete, defective, damaged, or having deteriorated, in which case a corresponding write-off will be required.

66. Returns also occur as a result of items having been incorrectly issued or because they are no longer required. Where the items have previously been reported as consumed, a credit to consumption is made at the same time as the items are brought on charge to the appropriate account - for example, return of expendable consumables and low value articles in use.

Revaluation

67. Where there is a difference between the recorded value of items being returned and the value recorded in the receiving account, the difference is reported in the RMC Revaluation Reserve account or the RMC financial provision account (as appropriate) in the receiving Management Group's accounts. The relative validity, accuracy and

appropriateness of the individual prices on the relevant databases are assessed to determine which price to use.

Physical Verification

68. PTs are responsible for physical verification and should be satisfied that the custodians are following appropriate physical verification procedures. See JSP 886 for stocktaking policy and procedures.

69. All RMC are subject to physical verification.

70. Stocktaking is undertaken to reconcile actual RMC holdings with recorded RMC holdings to verify the validity, accuracy and completeness of accounting records.

71. During stocktaking the location and condition of items, the level of RMC holdings (highlighting potential excess items) and the storekeeping arrangements should also be examined.

72. Departmental Materiel Accounting Regulations for continuous stocktaking remain extant but with an increased emphasis on high value items and stocktaking discrepancy rates. Stocktaking performance and results provide evidence of how adequate the arrangements are. See JSP 886.

73. Wherever practicable, continuous stocktaking is undertaken through a 70% by value quadrennial rolling programme, in accordance with JSP 886, which must cover 100% of all items over the 4 year period.

74. Where discrepancies are found, stocktaking adjustments are made in the accounting records after appropriate investigations have been concluded.

75. Stocktaking records and reports of performance and results should be completed.

Disposals

76. Items declared for disposal include those that are obsolete, defective, damaged or surplus to, or no longer fit for, known requirements.

77. RMC declared for disposal is valued at NRV (which may be zero, if appropriate).

78. Where the estimated disposal sales value or scrap value is very low or nil, items can be fully written-down by way of an RMC valuation impairment when issued for disposal. In most cases this should be nil as any sale proceeds will be retained by the Disposal Sales Authority.

79. Items declared for disposal for which receipts (either collected by the Disposal Sales Authority or generated from local sales) are anticipated to be separately identifiable

are transferred to the RMC Declared for Disposal account and evidence of their transfer retained. Receipts are matched with the NRV (Value of RMC Disposed) and any associated surplus or deficit on disposal, after deducting direct costs incurred in the sale, is reported at TLB level.

80. Items declared for disposal for which receipts (either collected by the Disposal Sales Authority or generated from local sales) are not anticipated to be separately identifiable on sale are transferred to the RMC Declared for Disposal (RMC) account. The receipts are offset against the balance on this account (Value of RMC Disposed) on a succession basis consistent with cyclical sales patterns. For example, current month receipts are offset against asset disposal postings in a specified prior month based on the average lead time between declaration for disposal and sales receipts. Any associated surplus or deficit on disposal (after deducting direct costs incurred in the sale) is reported at TLB level.

Disclosure

81. There is no requirement for war maintenance reserves to be disclosed separately in either the SOFP or the notes to the accounts.

82. The balance on the Inventories Revaluation Reserve is included within the Revaluation Reserve on the face of the SOFP. Elements of the Revaluation Reserve which are realised and transferred to the General Fund are disclosed separately in the notes to the accounts.

83. The following operating cost charges are disclosed separately in the SOCNE under programme costs:

a. RMC consumption;

b. surplus or deficit arising on disposal of RMC items (reported as exceptional items, where material);

c. impairments to reduce RMC to NRV (net of any amounts released);

d. write-offs for physical losses and stocktaking adjustments (net of write-ons);

e. reversals of RMC write-downs.

84. Details of write downs and any reversal of write-downs (including the circumstances leading to the reversal) are shown in the inventories note to the accounts where material.

Specific Accounting Treatments

Contracting for Availability Contracts

85. Contracting for Availability (CFA) contracts are sometimes referred to as Contractor Logistic Support (CLS) contracts or Integrated Operational Supply (IOS) contracts. Although their titles may vary, it is the nature of the arrangement rather than its title which determines the appropriate accounting treatment.

86. These types of contracts constitute arrangements under which the Department typically pays for the platform to be made available. The cost will include items of capital spares, GWMB or RMC used to achieve this.

87. CFA arrangements should be accounted for in accordance with Part 1 Chapter 7 paragraphs 88 to 91 below.

88. Contracts which fall within the remit of CFA contracts or display characteristics akin to CFA contracts should be assessed under IFRIC 4 (see Part 1 Chapter 5 paragraph 180) to determine whether the contract is, or contains, a lease. If it is a lease or if it contains one, IAS 17 should be applied to determine whether the lease is a finance or an operating lease (see Part 1 Chapter 5 paragraphs 183 and 184).

89. The contract should be assessed as a whole rather than just assessing the individual capital spares, GWMB or RMC items. If it is not or does not contain a lease, the contract costs should be expensed.

90. If the lease is an operating lease, the contract costs relating to the operating lease should be expensed and the operating lease disclosures followed. The remaining contract costs should be expensed.

91. If the lease is a finance lease, the contract cost should be disaggregated. Any capital spares should be capitalised as tangible NCAs (see Part 1 Chapter 5) and any RMC as current assets. A finance lease payable should also be established.

Construction Contracts

92. Work performed on Construction Contracts relates to work which the Department undertakes for external repayment customers. Accounting for construction contracts is governed by IAS 11, Construction Contracts. See Part 1 Chapter 3 paragraph 6.

Containers

93. A container is a receptacle which is specifically designed for the transportation or storage of an item of materiel. Containers are accounted for as RMC items or as grouped NCAs depending on the nature, quantity and value of the items concerned. See Part 2 Chapter 5 paragraph 121.

94. Empty packed fuel containers are recorded as individual RMC items and all issues and receipts are accounted for. Issues are expensed and returns are credited to RMC consumption.

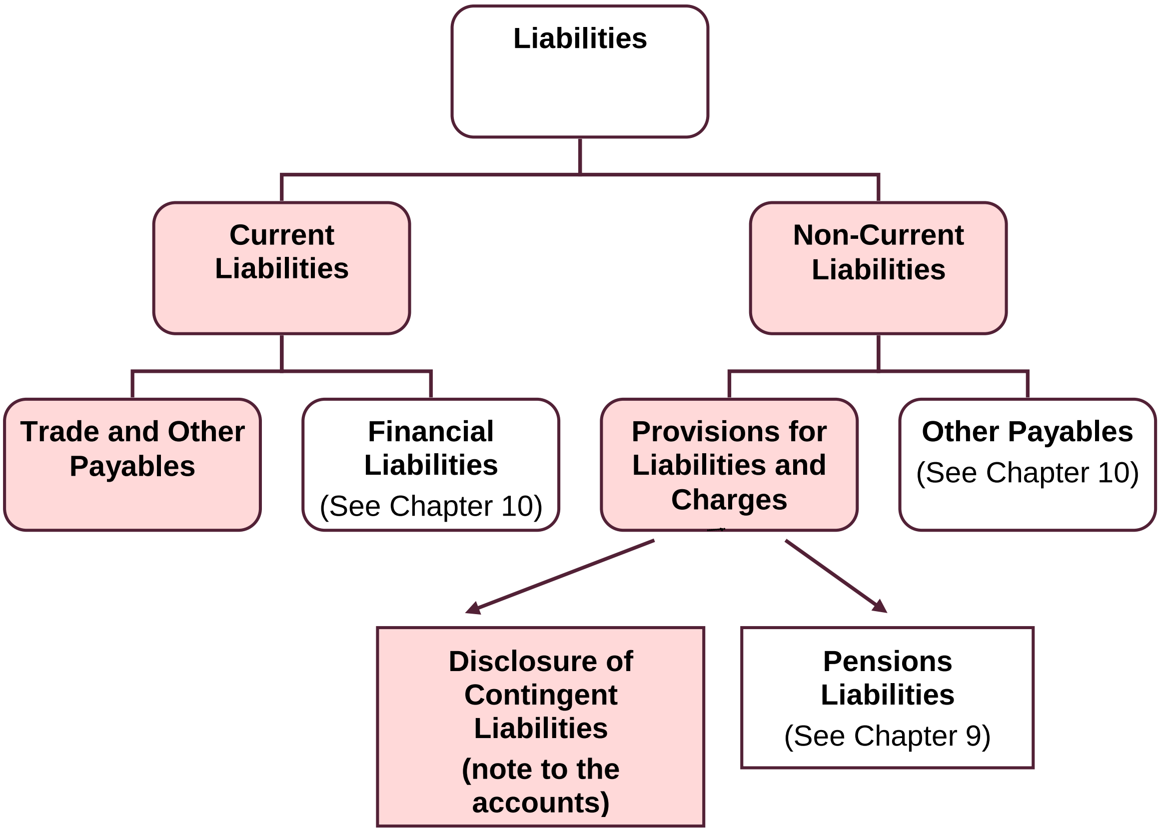
Items of Personal Equipment

95. The accounting treatment is covered in Part 1 Chapter 5 paragraph 19.

Guidance

96. Guidance on RMC categorisation and materiality in relationship to ownership and categories is given in Part 2.

8 Liabilities



Introduction

1. This chapter covers the financial accounting treatment and disclosure of current liabilities (i.e. those falling due within one year); provisions for liabilities and charges; and contingent liability disclosure requirements.

2. It should be read in conjunction with Part 1 Chapter 13, which explains the Managing Public Money (MPM) requirement for the Department to seek authority from HM Treasury and, in some cases, notify Parliament before it assumes certain actual and contingent liabilities.

3. Non-current other payables (i.e. those falling due after more than one year, excluding provisions) are covered in Part 1 Chapter 10. Accounting for pension schemes, including pension scheme liabilities, is covered in Part 1 Chapter 9.

Specific Responsibilities

4. Specific responsibilities are listed below.

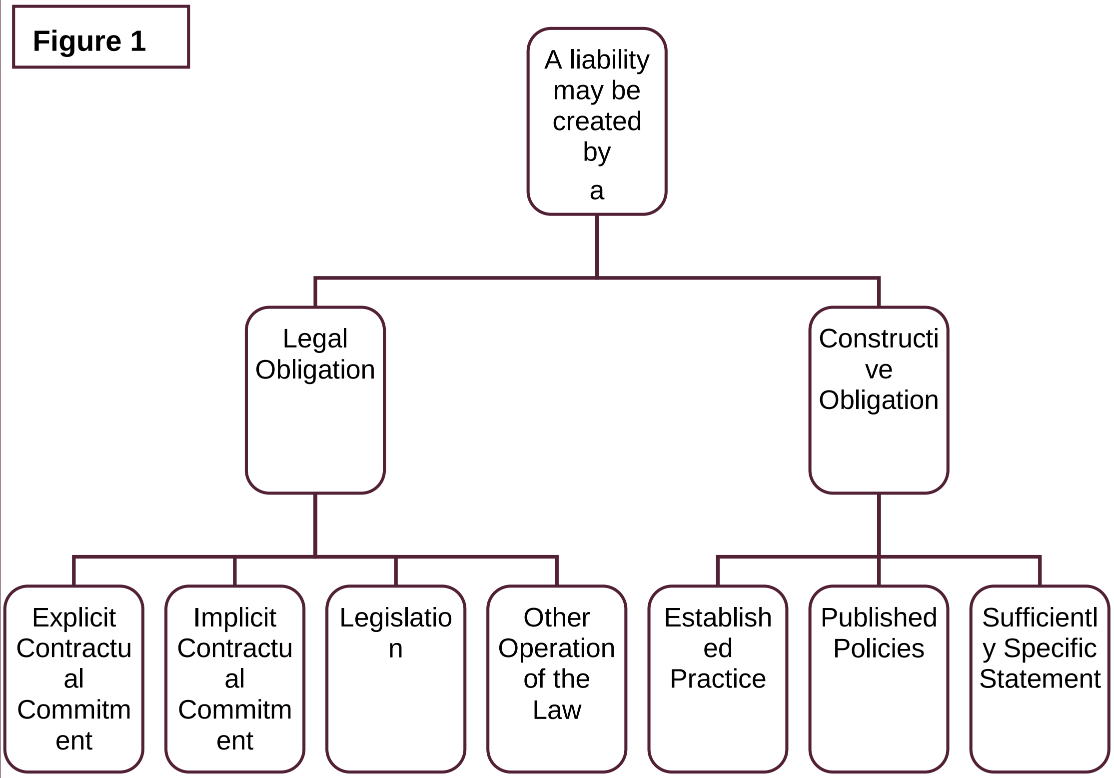
FMPA Corporate Financial Accounting Team (FMPA CFAT)

5. CFAT is responsible for approving the creation (or amendment) of a new (or existing) nuclear or non-nuclear provision, regardless of its value.

Liabilities

6. Liabilities are defined in Figure 1 below. A liability can arise from either a legal or a constructive obligation.

Figure 1



Current Liabilities

7. Current liabilities are those liabilities that are due within one year. The policy for ‘Trade and Other Payables’ is contained in Part 1 Chapter 8 paragraphs 8 to 18 below. The policy on ‘Financial Liabilities’ is contained in Part 1 Chapter 10.

Trade and Other Payables

8. The categories of trade and other payables are shown in Figure 2 below.

9. When recognising the cost of goods and services in the accounts, a distinction should be drawn between a ‘trade payable’ and an ‘accrual’. A trade payable represents a

liability to pay for goods or services which have been received or supplied and have been invoiced.

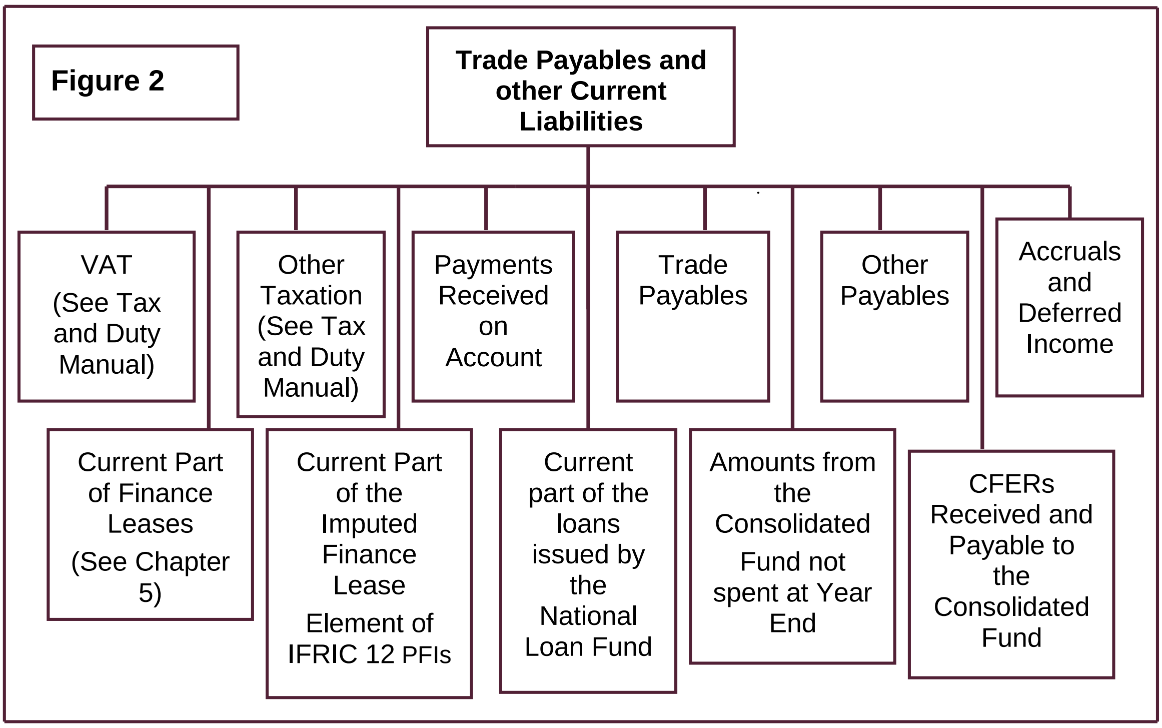


Figure 2

Accruals and Deferred Income

10. Accruals represent a liability to pay for goods and services that have been received but not invoiced. This includes amounts owed to employees. Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions. Examples of transactions included under the heading of accruals and deferred income are:

a. goods or services received but not invoiced;

b. deferred income (i.e. income received for goods and/or services not yet supplied);

c. unused annual leave;

d. rents payable;

e. services received.

11. Accruals are not usually made for the following (on materiality grounds):

a. pay and allowances (excluding Reserve Forces Bounty Payments);

b. national insurance;

c. travel and subsistence;

d. superannuation contributions adjusted for past experience (SCAPE);

e. manual accruals under £10,000 (i.e. manual accruals should only be made for £10,000 and above).

12. Under Departmental contracting arrangements, receipt of the red copy of MOD Form 640 acts as a proxy for a Goods Received Note (GRN) where goods are supplied on a 'one-off' basis. Where services are provided, an authorised MOD Form AG173 serves as a proxy for an invoice.

13. Where a contractor undertakes work at risk and the Department is not liable at the reporting period date for meeting the cost, an accrual should not be included in the accounts.

14. Charges that attract irrecoverable VAT (input tax) are accrued gross. Where VAT is fully recoverable, accrued balances are reported net of VAT.

15. In calculating the accrued value of completed work, all contractual stage or progress payments should be included.

16. The value of work completed on all major contracts is fully accrued where there is a contractual obligation to pay for it. The accrual is calculated by taking into account all stage or progress payments. The financial reporting processes for determining the accruals and the judgements being applied should be recorded to provide an adequate audit trail and where contractor input is required, DEFCON 647 should be written in a form that ensures adequate financial management information is provided by the contractor. Further details and examples of accruals are provided in Part 2 Chapter 8.

Short-Term Employee Benefits

17. Short-term employee benefits are defined as wages and salaries (including overtime), social security contributions, paid annual leave, flexi leave and post-operational tour leave. Short-term employee benefits should be accrued, with the exception of wages and salaries, which are not considered to be material by the Department. Special bonuses and bounties should be accrued where they are carried over from the previous financial year but due to be used or paid in the financial year after the service was rendered. Accrual for overtime, paid annual leave, flexi leave, post-operational tour leave and the civilian Performance Pay Award will be calculated and accounted for centrally (by FMPA CFAT) as part of the process of producing the Annual Accounts and TLBs should ensure they are not duplicating accruals for Short-Term Employee Benefits. Short-Term Employee Benefits do not include early retirement or departure benefits which are covered in Part 1 Chapter 8 paragraphs 44 to 50.

18. Short-term employee benefits should not be discounted.

Non-Current Liabilities

19. Non-current liabilities are liabilities that are due after more than one year. The policy for 'provisions' (excluding pension scheme provisions which is covered in Part 1 Chapter 9) is contained in Part 1 Chapter 8 paragraphs 20 to 36 below. The policy on 'Other Payables' is contained in Part 1 Chapter 10.

Provisions for Liabilities and Charges

20. Creating a provision ensures that a liability, which has arisen from a past or present obligating event but will not be settled until a future date, is charged in the accounts when it is first recognised.

21. A provision is a liability for which the amount or timing of the expenditure that will be undertaken is uncertain. Provisions can be distinguished from other liabilities such as trade payables and accruals because there is a higher level of uncertainty over the timing or amount of the future expenditure. Further details and examples are given in Part 2 Chapter 8.

22. Approval must be sought from FMPA CFAT before creating a new nuclear or non-nuclear provision, regardless of its value. Similar approval must be sought before amending the value of an existing provision. The assumptions underpinning the estimates in calculating the provision should be documented. These assumptions should be reviewed each financial year to ensure their continuing validity or to recalculate the estimate if the assumptions have changed. Detailed guidance is provided in the In Year Management Instructions.

<u>Recognition</u>

23. A provision is only recognised in the accounts when:

a. the Department has a present obligation, legal or constructive, to transfer economic benefits as a result of past events; and:

b. it is probable that a transfer of economic benefits will be required to settle the obligation; and

c. a monetary estimate of the amount of the obligation can be assessed with sufficient reliability.

24. A provision cannot be created to recognise:

a. a liability which arises from an executory contract, unless the contract becomes onerous (see Part 1 Chapter 8 paragraph 25);

b. expenditure which management could avoid by its own actions;

c. adjustments to the carrying value of assets, for example, to reflect depreciation or a provision for bad debts;

d. future expenditure to overcome a shortfall in funding.

25. An executory contract is one in which neither party has performed any of its obligations or alternatively both parties have performed their obligations in equal measure. An onerous contract is one in which the unavoidable costs of fulfilling the terms of the contract exceed the revenue or value of the equipment or services supplied under the contract and the other party would have to be compensated if the terms of the contract were not fulfilled. Provision should be made for onerous contracts.

26. When a provision for liabilities and charges is created, the double entry is effected through:

a. a charge to the Statement of Net Comprehensive Expenditure (SOCNE) if the Department will not derive any associated economic benefit - for example, from decommissioning an *out of service* nuclear submarine; or

b. the creation of a capitalised asset provision if the Department will derive economic benefit from the associated asset, for example, a nuclear test facility used to support in-service assets. The capitalised asset is given a unique identification number, recorded separately in the NCAR, and held in the same category as the associated asset. By depreciating it over the same timescale as the associated asset, the cost and economic benefit are matched.

27. Provisions for the restitution and decommissioning of Non-Current Assets (NCAs) are recognised in the accounts of the TLB which has the financial management responsibility for the related asset.

Measurement

Note that CFAT must be consulted for the current discount rate as the rate applied in context of this chapter is for illustrative purposes only.

28. Provisions are calculated at current year price levels. Where it is only possible to estimate a range of possible costs, the best estimate should be used. The minimum or maximum amount should only be used if it will provide the best estimate. If material, the minimum and maximum amounts should be disclosed separately.

29. Where material, provisions are discounted back to the reporting period date. The ‘real’ discount rate set by HM Treasury and promulgated by Public Expenditure System papers must be applied to future cash flows unless they relate to voluntary early retirement under pension scheme rules in which case the appropriate pension discount rate, as

advised by CFAT, should be used. There are three discount rates to be used for discounting general provisions:

a. a short-term real discount rate is applied to the cashflows of general provisions in a time boundary of between 0 and 5 years from the SOFP date;

b. a medium-term real discount rate is applied to the cashflows of general provisions in a time boundary exceeding 5 years and going up to 10 years from the SOFP date;

c. a long-term real discount rate is applied to the cashflows of all long-term provisions in a time boundary exceeding 10 years from the SOFP date.

30. The formula $1/(1+r)^n$ is used to discount future cash flows, where ‘r’ is the real discount rate and ‘n’ is the number of years over which the discounting applies (back to the date of the current reporting period). An example of how to discount a provision is provided in Part 2 Chapter 8.

31. Each year, the provision is adjusted to take into account inflation during the past year and one year's discount is removed as the future expenditures move a year closer. The unwinding of the discount is taken as an interest charge to the SOCNE.

32. As the inflation rate changes annually, the new rate should be assessed each year to ensure that the correct settlement cash flows are created. If no better information is available, the inflation rate used in the most recent Annual Budget Cycle can be applied. Capitalised asset provisions should not be subject to MHCA adjustment (i.e. NCA indexation) but should be revalued in accordance with latest prices for decommissioning provisions. The increase should be treated as an ‘Addition’ in the Annual Accounts.

33. Where the provision does not have a corresponding capitalised asset provision, cash flows which have been updated to reflect changes in assumptions and estimates should be stated at current prices and discounted to the Reporting Period date. These changes in value should be charged/credited to the SOCNE together with the annual charge for unwinding the discount factor and any changes arising from inflation/price changes. See Part 2 Chapter 8 for the accounting entries.

34. Where there is a capitalised asset provision that has not been fully depreciated, the carrying amount of the associated asset is adjusted to reflect any increase or decrease in the value of the provision. The balance is then depreciated over its remaining useful life. However, if the decrease in the provision exceeds the carrying amount of the asset, the excess should be recognised in the SOCNE. The inflation adjustment should be capitalised as should any changes arising from inflation/price changes and a change in the discount rate. See Part 2 Chapter 8 for the accounting entries.

35. Provisions for decommissioning costs and any capitalised provision assets are generally recognised by the PT that has financial management responsibility for the associated asset - for example, a submarine. Where the asset has never been, and will not be included in the accounts (for example, an asset may have a value below the NCA

capitalisation threshold), the provision should normally be recognised in the accounts of the PT responsible for managing the NCA category to which the asset belongs.

36. The financial effects of a change in the discount rate for early retirement provisions should be recognised in the SOCNE.

Disclosure

37. For accruals, the notes to the accounts should disclose amounts payable on stage payments and show separately the amounts which fall due after five years.

38. For provisions the following information is required:

a. a brief description of the nature of the obligation;

b. the estimated timing and value of the provision. Where there is significant uncertainty over either of these, the determining factors should be identified;

c. the amount provided for and, if estimated, the basis on which the estimate has been made including any range of estimates, if applicable;

d. the discount rate (if applicable);

e. an analysis of the expected timing of discounted flows;

f. movements in the year on each material class of recognised provision, separately identifying:

i. additional provisions made in the year;

ii. amounts used, i.e. charged against the provision;

iii. amounts released unused;

iv. the discount rate (if applicable);

v. amounts capitalised;

vi. amounts transferred;

vii. any foreign exchange differences.

Accounting for Specific Provisions

Provisions for Decommissioning and Restoration

39. A provision is created from the point at which contamination first occurs. For example:

a. nuclear submarines (hull, reactor plant and associated storage facilities). A provision for the full costs of decommissioning nuclear submarines should be created from the date on which the plant becomes operational. This recognises that no material obligation is created until the reactor is activated;

b. the national repository for eventual waste disposal. A provision should be created for the cost of operating the storage facility from the point at which the obligation to operate it and store the waste material first arose;

c. contaminated land. A provision should be created from the date on which the activities responsible for the contamination first take place.

40. The key assumptions underpinning the estimates used in calculating the provision should be documented by the PT and disclosed in the Annual Accounts. For decommissioning and restoration provisions, these are likely to be the time period over which the provisions are estimated, the costs for the future storage and decommissioning of waste, the VAT rate and the discount rate used. For example, if the best estimate of the probable date of decommissioning is likely to vary significantly, the notes to the accounts should show the potential effect on the value of the provision as a result of the present value of the cash flows changing.

41. Where expenditure covered by a decommissioning or abandonment provision will give rise to future Departmental outputs, the provision is capitalised and included in the value of the associated asset. The capitalised value is depreciated over the estimated useful life of the asset. Apart from the cost of unwinding the discount, which is expensed as an interest charge to the SOCNE, all subsequent changes to the value of the provision are capitalised unless a decrease in the provision exceeds the asset's carrying amount (in which case, the excess is recognised in the SOCNE).

Provisions for Restructuring/Reorganisations

42. A provision for restructuring is recognised from the point at which the organisation is demonstrably committed to the reorganisation, cannot realistically withdraw from it and has a detailed plan for its implementation.

43. It can only include expenditure which arises directly from the restructuring or the reorganisation activities and therefore excludes any costs associated with new or on-going business activities such as the cost of retraining or relocating staff remaining with the business.

Provisions for Early Release or Redundancy

44. Termination benefits are as a direct result of termination of employment and are unrelated to future employee service. They should be recognised at the earlier of:

a. when the offer cannot be withdrawn (interpreted at Part 1 Chapter 8 paragraphs 46 and 47 below);

b. when the related restructuring costs are recognised under IAS 37, Provisions, Contingent Liabilities and Contingent Assets.

45. The Department retains responsibility for financing all early retirement costs up to Normal Retirement Age (NRA), which is usually set at age 60, after which the normal occupational pension scheme funding arrangements take effect. For example, if the civilian is a member of the PCSPS, funding responsibility would transfer to the Office of Public Service (OPS) after NRA. However, the additional element payable beyond NRA, which derives from the enhancement of reckonable service, continues to be met by the Department.

46. A provision for early release to represent the future liability to pay early pensions and/or lump sum payments should be made at the earlier of when the related restructuring costs are recognised under IAS 37, or when a letter offering early release or early departure is issued to individuals and is accepted by them in writing. The provision is recognised as an accrual when the early release dates are agreed. These two actions may occur at the same time, in which case just an accrual is created.

47. For a compulsory redundancy scheme, a provision should be made at the earlier of when the related restructuring costs are recognised under IAS 37, or when the Department can no longer withdraw the offer of those benefits. The Department can no longer withdraw the offer when the entity has communicated to the affected employees a plan of termination, meeting all of the following criteria:

a. actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made;

b. the plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and their locations (but the plan need not identify each individual employee) and the expected completion date;

c. the plan establishes the termination benefits that employees will receive in sufficient detail that employees can determine the type and amount of benefits they will receive when their employment is terminated.

48. The provision referred to in Part 1 Chapter 8 paragraph 47 is recognised as an accrual when the individuals are notified and redundancy dates are agreed. These actions may occur at the same time as those actions that meet the criteria for making a provision, in which case just an accrual is created.

49. Voluntary early retirements under pension scheme rules should be discounted at the pension's discount rate and not the provisions discount rate. The financial effects of a change in the discount rate for early retirement provisions should be recognised in the SOCNE.

50. The employing TLB is responsible for calculating future civilian early retirement and departure provisions.

Provisions for Dilapidation

51. Many property leases include a tenant repairing clause which places a legal obligation on the tenant to return the property to the landlord in a specified condition at the end of the tenancy.

52. At the inception of a lease which contains a dilapidations clause, the future estimated costs of dilapidations should be disclosed as a contingent liability. However, if during the duration of the lease a sufficiently reliable monetary estimate of the dilapidation costs can be assessed and it is probable that a transfer of economic benefits will be required to discharge the obligation (for example, once a decision to terminate the lease has been made), a provision for dilapidations should be created and charged to the SOCNE.

53. Normal maintenance expenditure should be charged to the SOCNE as incurred.

Contingent Liabilities

54. A contingent liability reflects:

a. a possible obligation, legal or constructive, that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the Department's control; or

b. a present obligation, legal or constructive, that arises from past events but is not recognised in the accounts because:

i. it is not probable that a transfer of economic benefits will be required to settle the obligation; or

ii. the amount of the obligation cannot be measured with sufficient accuracy.

55. A contingent liability is not included in accounting balances but may be disclosed in the notes to the accounts. All contingent liabilities should be regularly reviewed to determine whether an outflow of resources embodying economic benefits has become sufficiently probable to make it necessary to create a provision.

56. Each class of contingent liability disclosure should include a brief description of the nature of the contingent liability and, where practical:

a. an estimate of its financial effect (discounted where material);

b. an indication of the uncertainties relating to the amount or timing of any outflow;

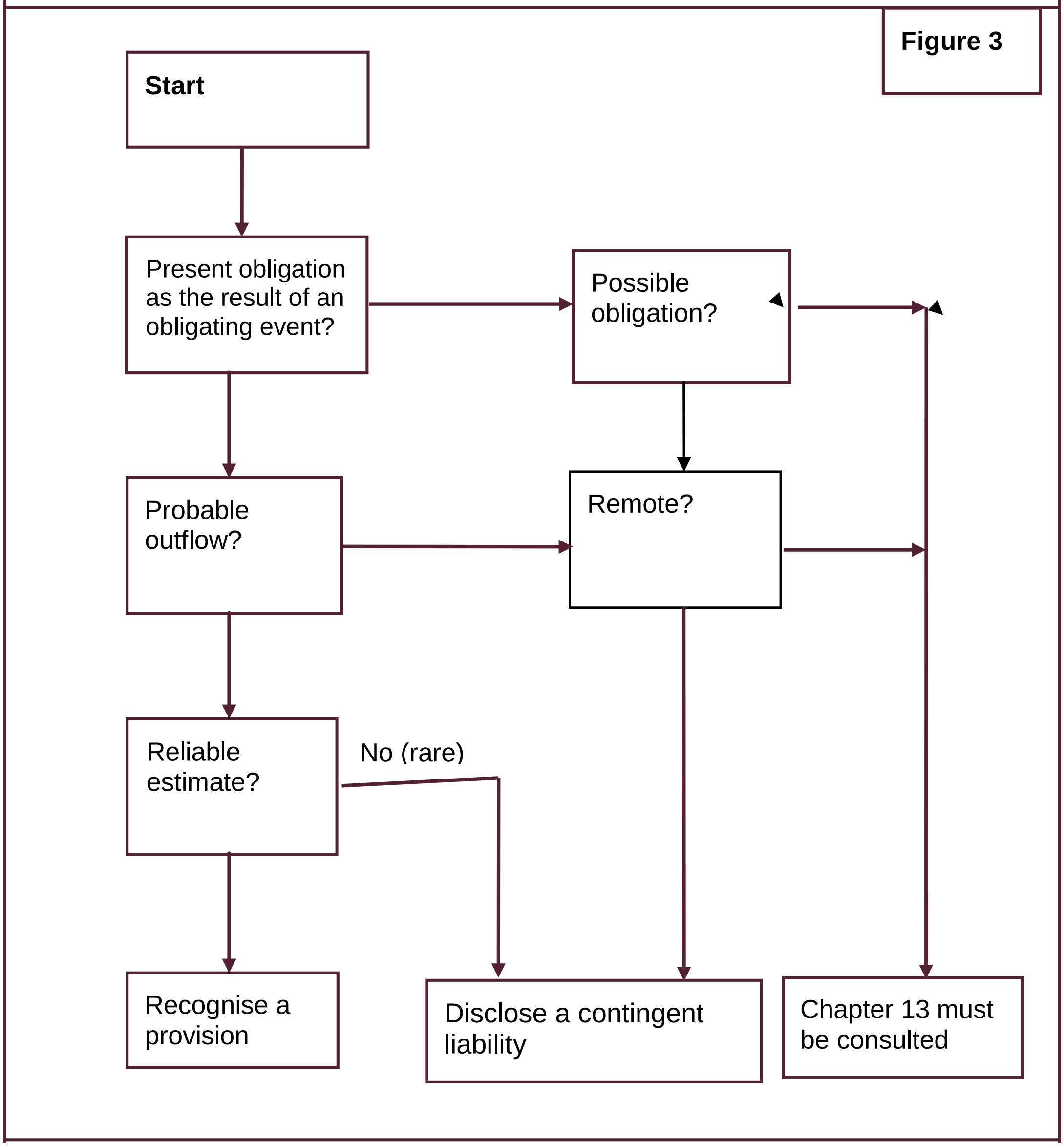
c. the possibility of any reimbursement.

57. Separate disclosure of information about a particular contingency may not be made if the publication of such information could be expected to be seriously prejudicial. The relevant amount should be included in the aggregate figure for such contingencies. CFAT should be consulted prior to the application of this exemption.

58. See Figure 3 for the main recognition requirements for provisions and contingent liabilities. See Part 1 Chapter 2 paragraph 29 for the policy on contingent assets.

Summary of the Main Recognition Requirements for Provisions and Contingent Liabilities

Figure 3



Guidance

59. Guidance on accruals, deferred income and provisions is given in Part 2.

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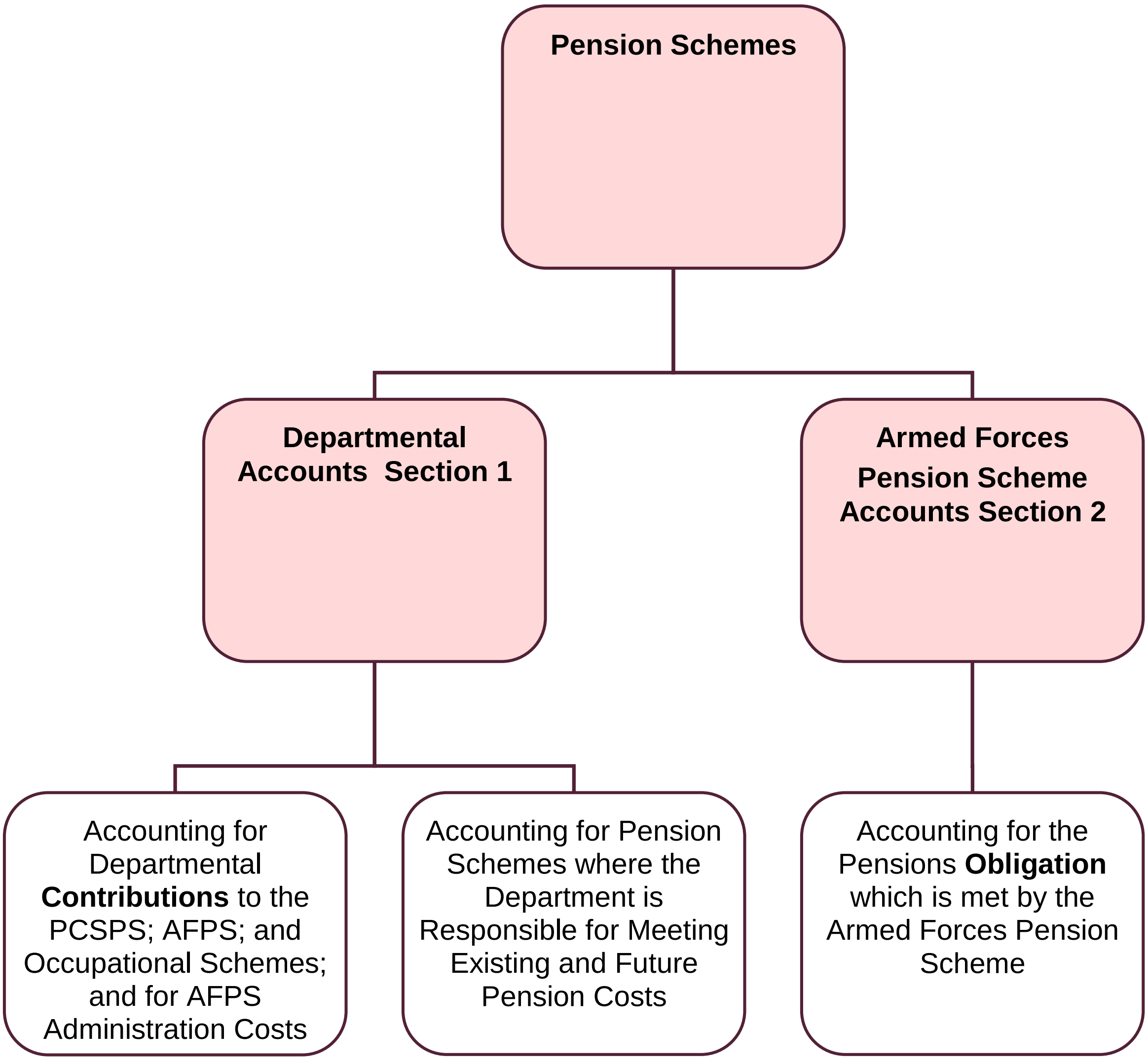
9 Pension Schemes



Introduction

1. This chapter covers pension accounting. In doing so, it differentiates between the pensions accounting policy adopted by the Department, as an employer, and the pensions accounting policy adopted by the Defence Business Services (DBS) Military Personnel, as administrator of the Armed Forces Pension Scheme (AFPS).

Specific Responsibilities

2. Specific responsibilities are listed below.

DBS Military Personnel

3. The DBS Military Personnel administers the Armed Forces Pension Scheme (AFPS).

SCAPE

4. SCAPE contributions represent the estimated cost of providing future superannuation protection for civilian personnel currently in employment (other than those whose pension is paid directly from the Department's own resources) and also for serving military personnel.

5. The PCSPS and the AFPS are unfunded 'defined benefits' schemes. Therefore, although no fund is built up, each scheme is financed to meet specified levels of benefits payable under particular circumstances.

6. The amount of future benefit is linked to various factors, most notably to the amount of final salary and to the number of years served. As this information is not known in advance, the future cost of providing benefits is actuarially assessed.

7. For civilian personnel, staff are grouped according to salary band and the rate at which SCAPE is payable is calculated as a percentage of the salary band. For military personnel there are two rates (one for officers and one for other ranks). Contribution rates are reassessed every three years.

8. TLBs responsible for the related salary costs account for SCAPE on an accruals basis through their SOCNE.

9. The AFPS accounts for SCAPE as income and shows it on the scheme's Revenue account at the reporting period date.

10. SCAPE is transferred to the Office of the Paymaster General's superannuation account and outstanding amounts are accounted for as a payables balance.

Section 1 – Civilian Pension Schemes

11. The PCSPS is a defined but unfunded benefit scheme, whose benefits are secured against future tax yield and paid by the Office of Public Service (OPS) as they fall due. The future cost, which is determined by factors such as final salary and the number of years served, is actuarially assessed.

12. The Department also operates a number unfunded defined benefit schemes where pensions are paid directly from the Department's own resources. In addition, it participates in a funded defined benefit scheme. Funded and unfunded schemes should normally be accounted for as described in Figure 1. However, HM Treasury has stated that the Department's defined benefit pension schemes for civilians employed in Gibraltar and Cyprus should use the discount rate (both nominal and real) advised by the schemes' actuaries. The rates will be specific to the particular scheme. If there are cost or practicality

issues associated with this, the next best discount rate assumptions to use are the CPI derived assumptions as per the pensions' discount rate PES paper issued annually by HM Treasury, provided that the end result from doing so is not materially different.

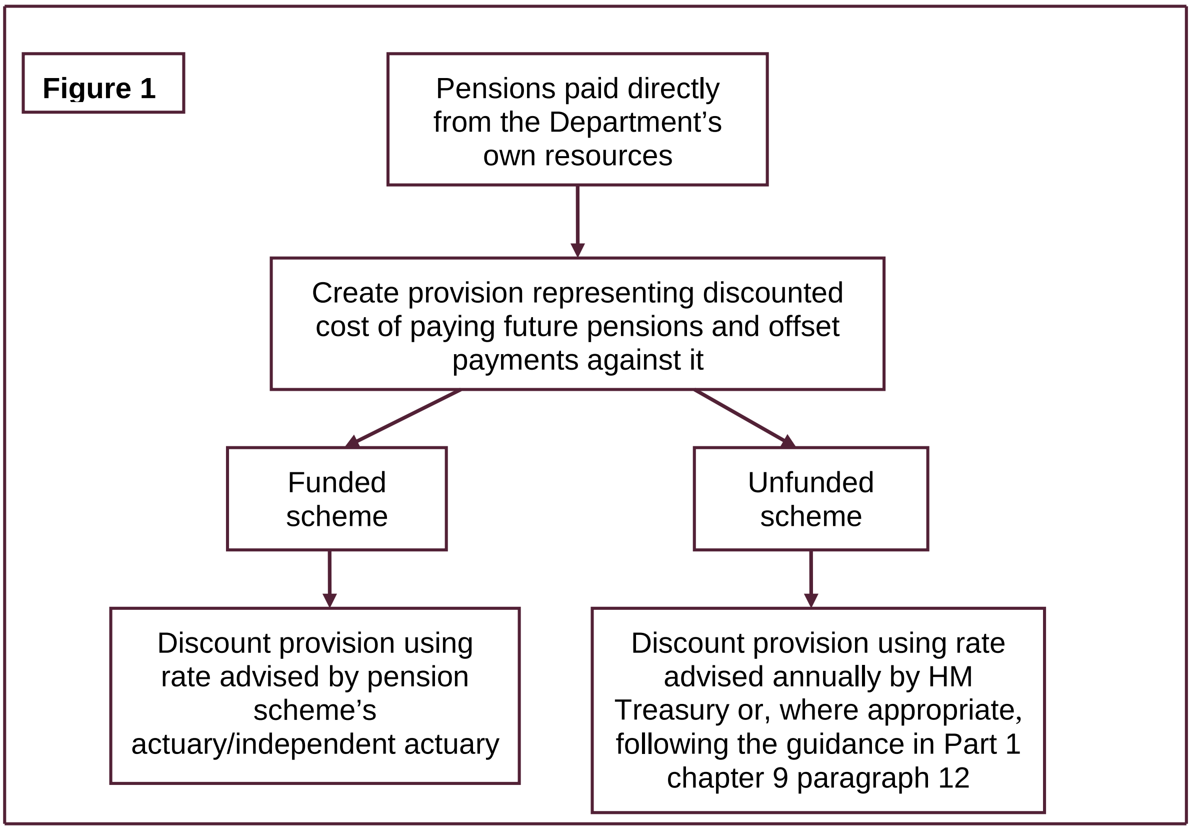


Figure 1

13. The provision is calculated on an actuarial basis using the projected unit basis (i.e. allowing for future salary inflation) and discounted to reflect the time value of money (see Figure 1 above).

14. Full actuarial valuations must be obtained from a professionally qualified actuary at least every four years. Actuarial gains and losses, including those arising from a change in the discount rate, should be recognised in reserves. Current and past service costs and the unwinding of the discount rate should be charged to the SOCNE.

15. Approximate assessments, based on the latest available membership data, are acceptable during intervening years.

Disclosure Requirements

16 The disclosure requirements of the FReM Chapter 9 should be followed. Disclosure requirements are also listed in the HM Treasury pro-forma accounts Departmental Yellow and Magenta Pension Scheme. The disclosure requirements that are listed Part 2 Chapter 9 paragraphs 2 to 10 are to assist TLBs in meeting those disclosure requirements. However, in the case of applying the disclosure requirements to any individual pension

scheme, a conflict or difference arises between that listed below and those stated in the FReM, the disclosure requirements of the FReM must be followed.

Section 2 – Armed Forces Pension Scheme (AFPS)

17. The Armed Forces Pension Scheme (AFPS) is a contracted-out , unfunded, defined benefit, pay-as-you-go occupational pension Scheme operated by Defence Business Services on behalf of members of the Armed Forces who satisfy certain membership criteria.

18. As the Scheme lies outside the budgetary control total imposed by HMT, it is reported separately in independent pension Scheme accounts, which incorporate the AFPS15, AFPS 75, AFPS 05, Reserve Forces Pension Scheme (RFPS), Gurkha Pension Scheme (GPS), Non-Regular Permanent Staff (NRPS) Pension Scheme, Full-Time Reservists (FTRS) Pension Scheme, several minor Pension Schemes and the Armed Forces Compensation Scheme (AFCS).

19. Although no fund is built up, the pension Scheme rules specify the level of, and the circumstances under which, benefits are to be paid. The Scheme is financed from Employer Contributions and the HMT Consolidated Fund. Funding from the Consolidated Fund is required to meet the difference between payments to pensioners and the amounts receivable from MOD. In addition, funding is required to finance movements in working capital including increases or decreases in bank balances.

20. Whereas in the separate AFPS accounts the Scheme is treated as a defined benefit Scheme, in the MOD Annual Accounts it is accounted for as if were defined contribution Scheme, with SCAPE charges and the cost of administering the scheme recognised in the SOCNE.

Financial Statements

21. The financial statements of the combined Scheme are prepared in accordance with the relevant provisions of the Government Financial Reporting Manual (FReM) issued by HMT. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector. IAS 19 Employee Benefits and IAS 26 Accounting and Reporting by Retirement Plans are of particular relevance to these statements. The statements recommended (and reflected in the Magenta statements) are:

a. Report of the Scheme's Managers;

b. Report of the Scheme's Actuary;

c. Statement of the Accounting Officer's responsibilities;

d. The Governance Statement;

e. Certificate and Report of the Comptroller and Auditor General;

f. The Accounting Schedules:

i. Statement of Parliamentary Supply;

ii. Combined Statement of Comprehensive Net Expenditure;

iii. Combined Statement of Financial Position;

iv. Combined Statement of Changes in Taxpayers' Equity;

v. Combined Statement of Cash Flows.

g. Notes to the Accounts.

22. Comparative figures should be shown throughout. The AFPS Accounts are prepared under the historical cost convention.

23. Further details on how AFPS should be accounted for is given in Part 2 Chapter 9 paragraphs 11 to 57.

Guidance

24. Guidance on civilian pension schemes and the AFPS is given in Part 2.

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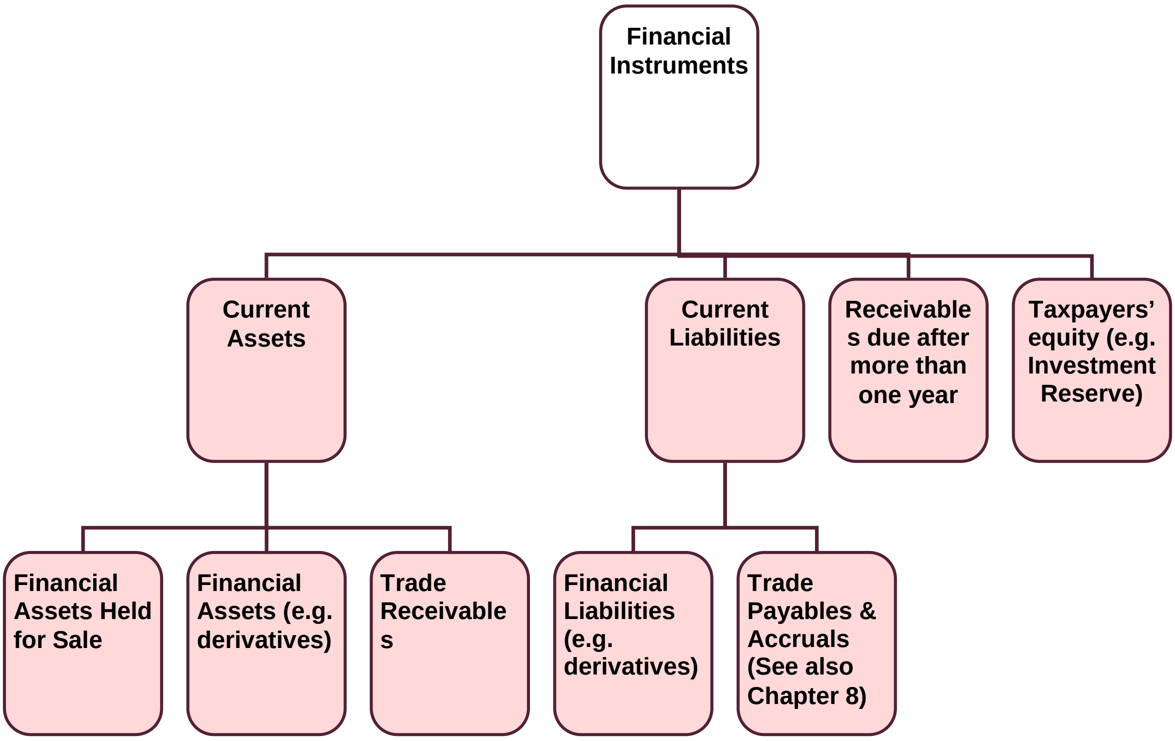
10 Financial Instruments



Introduction

1. This chapter sets out the accounting requirements for assets, liabilities and transactions classified as financial instruments. Accounting direction on trade payables and accruals is contained in Part 1 Chapter 8.

Specific Responsibilities

2. Specific responsibilities are listed below.

FMPA Accounting and Treasury Management Team (FMPA A&TM)

3. FMPA A&TM is responsible for implementing the accounting policy for:

   a. the Department's foreign currency forward purchase contracts;

   b. the Department's fixed price fuel swaps.

Definitions

4. A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

5. A financial asset is mainly an asset that is cash; an equity instrument of another entity; or a contractual right to receive cash or another financial asset from another entity. Loans, receivables and cash are examples of financial assets.

6. A financial liability is a liability that is mainly a contractual obligation to deliver cash to another entity or to exchange financial assets or liabilities under conditions that are potentially unfavourable.

7. An equity instrument is a contract that entitles an entity to receive an interest in the ownership of another entity. Ordinary share capital is the most basic form of equity instrument. It represents an ownership interest in a corporation, including an interest in earnings that translates into declared dividends and also an interest in assets distributed on dissolution.

8. A derivative is a financial instrument that must have all of the following characteristics:

   a. its value changes in response to a change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of rates or prices, credit rating or other variable; and

   b. it requires no or little initial investment; and

   c. it is settled at a future date.

9. An embedded derivative is a feature within a contract that causes the associated cash flows to behave in a similar fashion to a stand-alone derivative.

10. Fair value is defined as the amount for which an asset could be exchanged or a liability settled between knowledgeable willing parties in an arm's length transaction. A hierarchy should be used to determine the fair value of the financial instruments within its scope:

   a. quoted market prices in an active market are the best evidence of fair value and should be used, where they exist, to measure the investment;

   b. if the market for a financial instrument is not active, an entity should establish fair value by using a valuation technique that will produce a value that most closely replicates the market price;

c. if there is no active market for an equity instrument and the range of reasonable fair values is significant but cannot be estimated reliably, the equity instrument should be measured at cost less impairment.

Ownership and Control

11. The terms of ownership are formally recorded in the documentation relating to the financial instrument and, in the case of Trading Fund Agencies, the Framework Document. In most cases ownership rests with the Secretary of State for Defence. Where a TLB has issued a loan to a Trading Fund, the TLB is responsible, on behalf of the Secretary of State for Defence, for making the appropriate accounting entries.

12. Where financial instruments are not held to further the outputs of the Department but are held on behalf of Government more generally, they are accounted for in separate Trust Fund Statements, the format of which is dependent upon the item in question. TLBs should liaise with FMPA A&TM if they are considering holding financial instruments of this type.

13. Copies of documents of title or formation (such as a Framework Document) must be safeguarded and made available for periodic review by internal and external auditors.

Presentation

14. On initial recognition, the Department should classify a financial instrument as a financial asset, financial liability or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial asset, financial liability and an equity instrument.

15. Under IAS 32, a financial instrument is an equity instrument only if there is no contractual obligation or economic compulsion to deliver cash or another financial asset to the holder of the instrument. Preference shares that have been classified by the Companies Act as shares and presented in non-equity shareholders' funds should be presented as financial liabilities (i.e. a loan) and related dividends as interest payments.

16. Dividends from equity instruments are to be debited directly to equity. In the unlikely event that the MOD issues equity instruments (except for PDC) to a creditor to extinguish all or part of a liability and the equity instruments are recognised initially, they should be measured at fair value. If fair value cannot be reliably measured, then the equity instruments should be measured to reflect the fair value of the financial liability extinguished.

17. Trading Funds' Public Dividend Capital (PDC) should not be disclosed as a financial instrument in the Annual Accounts. PDC should be reported at historic cost less any impairment in the Department's Annual Accounts.

18. In the Trading Funds' financial statements, unpaid dividends from PDC are presented in their income and expenditure account and are accounted for as liabilities

within their Statement of Financial Position (SOFP). In the Annual Accounts they are accounted for as a receivable.

19. Golden shares (i.e. shares retained in businesses that have been privatised but in which the Department wishes to retain a regulatory interest or to reserve power) should not be recognised on the Department's SOFP. However, disclosures are required (see Part 1 Chapter 10 paragraph 75).

20. A financial asset and a financial liability are offset and the net amount presented in the SOFP when the Department:

a. has an existing legally enforceable right to set off the recognised amounts; and

b. intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

21. Interests in associated undertakings and joint ventures falling within the Departmental boundary should be recognised in accordance with IAS 28 and IAS 31. Part 1 Chapter 1 paragraphs 38 to 43 provides further details.

Recognition and Measurement

22. The Department should not recognise a financial asset or a financial liability on its SOFP until it becomes party to the contractual provisions of the instrument.

23. Initial recognition of a financial instrument should be at fair value and, in the case of financial assets or financial liabilities not categorised at fair value through profit or loss, should include all transaction costs that are directly attributable to their acquisition or issue.

24. Where future cash flows are discounted to measure fair value, the discount rate used should be the higher of the rate intrinsic to the financial instrument and the discount rate set by HM Treasury (2.2%).

25. Subsequent measurement depends on how the financial instrument is categorised. If it is considered that financial assets and liabilities should be categorised as financial assets and liabilities at fair value through profit and loss and, in the case of non derivative financial assets, as available for sale, FMPA A&TM must be consulted as HM Treasury approval will be required. In addition, FMPA A&TM must be consulted before any financial assets or liabilities are reclassified as HM Treasury approval is similarly required.

26. Financial instrument categories and their subsequent measurement are described in the following paragraphs and Figure 1.

Financial Assets and Liabilities at Fair Value through Profit and Loss

27. These include financial assets and liabilities that are deemed to be held for trading or financial instruments that an entity elects, at initial recognition, to classify within this category (for example, to eliminate or reduce a measurement or recognition inconsistency).

28. A financial asset or liability is deemed to be held for trading if it is acquired or incurred principally for the purpose of selling it or repurchasing it in the near future or if it is a derivative.

29. A derivative must always be treated as a financial asset or liability held for trading, irrespective of the Department's motive for holding it.

30. Following initial recognition all financial assets and liabilities held for trading should be measured at their fair value. The best evidence of fair value would be the quoted prices in an active market. The movements in fair value should be taken to the Statement of Comprehensive Net Expenditure (SOCNE). Financial instruments within this classification are not tested for impairment.

Held to Maturity Investments

31. These are non-derivative financial assets with fixed or determinable payments which an entity has the ability and the positive intention to hold to maturity (but which cannot be equities). However, a number of very strict criteria need to be met.

32. After initial recognition all financial assets and liabilities classified as held to maturity investments should be measured at their discounted cost (i.e. the net present value of estimated future cash-flows) less any impairment.

Loans and Receivables

33. These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which the entity has no intention of selling in the immediate or near term.

34. They are subsequently measured at discounted cost less any impairment. The discount rate should be the higher of the rate intrinsic to the financial instrument and the discount rate set by HM Treasury (2.2%). Where the time value of money is not material, they can be held at cost.

Available for Sale Financial Assets

35. This classification covers non-derivative financial assets that are not classified as financial assets at fair value through profit or loss, held to maturity financial assets or loans and receivables.

36. Available for Sale Financial Assets are subsequently measured at fair value, which is generally their quoted market price without any deductions for selling costs. Movements in their fair value are recognised through the Revaluation Reserve unless they are equity instruments with no quoted market price and whose fair value cannot be reliably measured, in which case they are subsequently measured at historical cost.

Available for Sale Financial Assets Subsequently Measured at Fair Value

37. These should be reviewed annually for impairment. However, an impairment should only be recognised if there is objective evidence to support it - for example, the issuer is having significant financial difficulties.

38. When a decline in the fair value of an available for sale financial asset has been recognised directly in the Revaluation Reserve and there is objective evidence that the asset is impaired, the cumulative loss recognised in the Revaluation Reserve should be removed and charged to the net operating cost section of the SOCNE even though the financial asset has not been derecognised.

39. Impairments to an investment in an equity instrument which is classified as available for sale (for example, shares held in a publicly quoted company) and recognised in the SOCNE should not be reversed through the SOCNE.

40. If in a subsequent period, the fair value of a debt instrument (classified as available for sale) increases and the increase can be objectively linked to an event which has occurred after the impairment was recognised in the SOCNE, the impairment can be reversed and the value of the reversal recognised in the SOCNE.

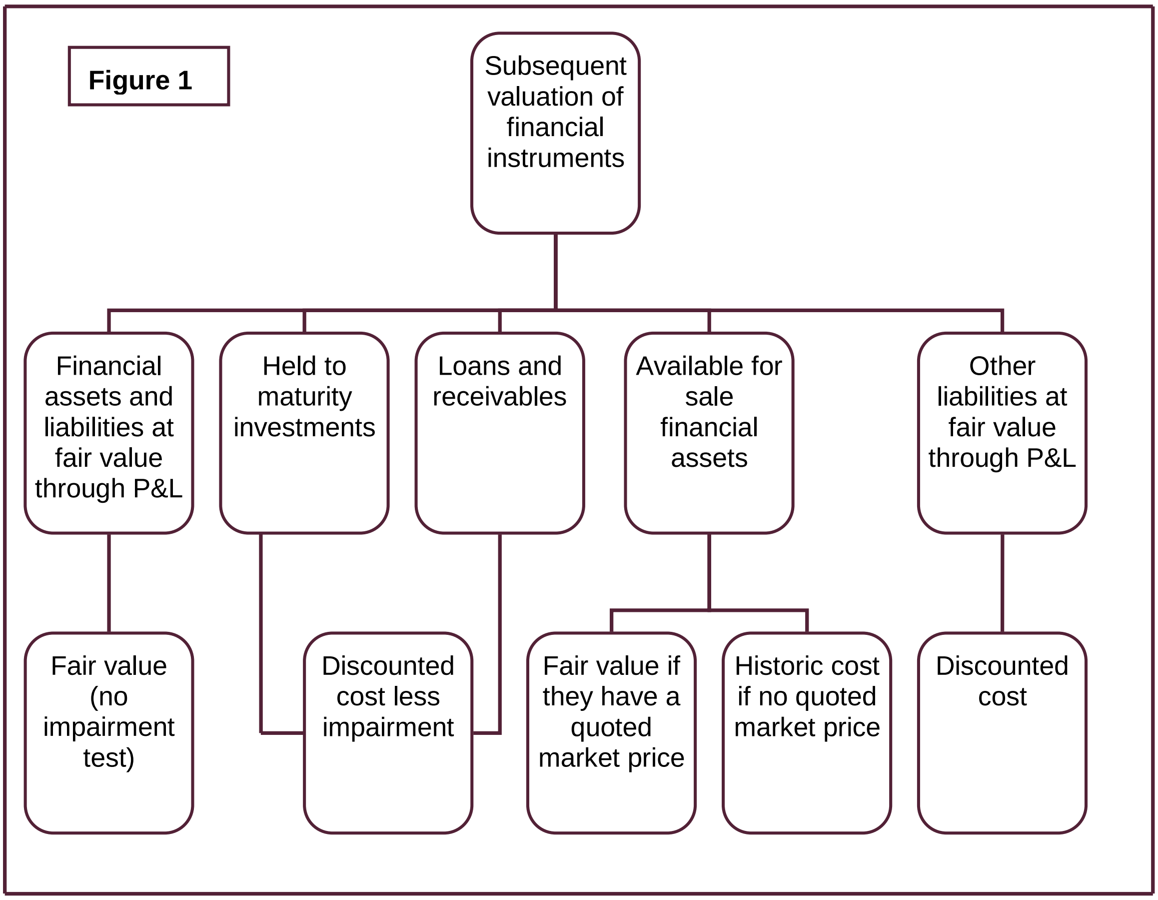
41. On disposal of an available for sale financial asset, any associated Revaluation Reserve balance should be recognised in the SOCNE as a gain or loss.

Available For Sale Financial Assets Subsequently Measured at Historic Cost

42. These should also be tested for impairment and any impairment charged to the SOCNE. Such impairment losses should not be reversed.

43. Non-Trading Fund dividend income generated by available for sale financial assets should be recognised in the period in which the dividends are declared by the entity at its general meeting. Trading Fund dividend payments not made by the year-end should be accrued.

44. Any interest receivable on available for sale financial assets is recognised in the SOCNE.



Provision for Bad Debts

45. A provision for bad debts should be made where there is significant doubt that the sums due will be received in full. This is after taking into account the risks attached to slow payment and the overall credit risk. It should be noted that a financial asset is impaired (and hence provision is made) if, and only if, there is objective evidence of impairment due to one or more events occurring after the asset was first recognised. As a result, the use of general provisions covering a range of bad and doubtful debts is precluded.

46. Each receivable should be reviewed for specific indications that the debtor will be unable or unwilling to settle all or part of the debt. Examples of indicators include significant financial difficulty of the debtor or a breach of contract. When the debtor is in financial difficulty and there is little historical data relating to similar receivables, experienced judgement will be needed to estimate an appropriate provision. All assumptions should be documented.

47. Where a debt is known to be irrecoverable, it should be written off.

48. Provisions for bad debts include irrecoverable VAT. However, VAT previously paid to HMRC is recoverable if the bad debt is subsequently written-off.

49. Receivables are shown in the accounts net of any provision for bad debts. All provisions and debt write-offs are charged to the SOCNE of the TLB to whom the income was due.

Provision for Credit Notes

50. Specific provision should be made for any credit notes to be issued which have not been processed to the sales ledger. Under Order to Cash credit memos are raised on receipt of the DAB1.

51. Credit note provisions are calculated exclusive of VAT, except where the tax point for the invoice falls within the period and the VAT has been treated as recoverable in the VAT return.

52. Receivables are shown in the accounts after any provision for credit notes.

Other Liabilities

53. Other Liabilities cover financial liabilities that are not included within 'financial assets and liabilities at fair value through profit and loss' and include trade payables, accruals, deferred income and liabilities arising from financial risk (i.e. financial instruments such as financial guarantee contracts that transfer credit risk to the entity, see Part 1 Chapter 10 paragraph 57).

54. Liabilities, including contingent liabilities, which arise from non-financial risks such as damage to property, claims made under product warranties and the outcome of legal actions, are governed by the requirements of IAS 37 – Provisions, Contingent Liabilities and Contingent Assets (see Part 1 Chapter 8).

55. The financial liabilities that fall within the classification of Other Liabilities are subsequently measured at discounted cost, using the higher of the rate intrinsic to the financial instrument and the discount rate set by HM Treasury (2.2%).

56. Liabilities need not be discounted if the time value of money is deemed not to be material.

Financial Guarantee Contracts

57. Liabilities which arise under financial guarantee contracts fall within the scope of IAS 39 (financial instruments) rather than IAS 37 (Provisions, Contingent Liabilities and Contingent Assets). All other provisions, including those arising from statutory, constructive and other contractual obligations (not giving rise to credit risk) are covered by IAS 37.

58. A financial guarantee contract requires the issuer to make specified payments to reimburse the holder for a loss it incurs as a result of a specified debtor failing to make due payment. Financial guarantee contracts can have various legal forms, such as that of a

guarantee, some types of letter of credit, a credit default contract or an insurance contract - for example, Navy Command indemnifies companies hired to tow foreign warships in UK ports against the possibility of non-payment of any claims or debts.

59. Financial guarantee contracts not accounted for as insurance contracts are initially recognised at fair value. In the context of the public sector, the fair value of a financial guarantee contract is usually estimated using a discounted cash flow analysis which incorporates an assessment of the probability of an event occurring that would give rise to a claim under the contract.

60. Subsequent changes in the probability assessment should not be reflected in the carrying amount of the financial guarantee contract, unless the result is such that IAS 37 would require the liability to be recognised because it is more probable than not that a transfer of resources will occur. Financial guarantee contracts are revalued (if appropriate) at AP09 and AP12 and movements in the valuation are taken to the SoCNE.

Embedded Derivatives

61. Some contracts which are not themselves financial instruments may contain an embedded financial instrument.

62. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, commodity price, foreign exchange rate, index of prices or rates or other variable (provided that in the case of a non-financial variable, any impact will affect all parties to the contract).

63. A derivative that is attached to a financial instrument but is contractually transferable independent of that instrument is a separate financial instrument rather than an embedded derivative.

64. An embedded derivative must be accounted for in the same way as a stand alone derivative, i.e. at fair value on the SOFP with changes recognised in the SOCNE.

65. The requirement to separate an embedded derivative from a host contract and account for it as a derivative should be undertaken when the Department first becomes party to the contract. TLBs should ensure that all contracts let since 1 April 2010 are reviewed for embedded derivatives. Subsequent re-assessment is prohibited unless a change in the contract terms will significantly modify the expected cash flows.

66. An embedded derivative should be separated from its host contract and accounted for as a derivative when all of the following conditions are met:

a. the economic risks and characteristics of the embedded derivative are not closely related to those of the host contract; and

b. a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

c. the entire instrument is not already measured at fair value with changes in fair value recognised in the SOCNE.

67. If an embedded derivative is separated, the host contract is accounted for under the appropriate standard - for example, IAS 39 if the host contract is a financial instrument or IAS 16 for the purchase of an NCA.

68. The Department has various types of contract pricing arrangements for purchasing goods and services. These include embedded derivatives, such that the cash flows of the combined contract vary in a way similar to a standalone derivative. Due to the complex nature of embedded derivatives and the difficulties in defining them, it is not possible to produce an exhaustive list of all potential embedded derivatives. However, a number of examples are provided in Part 2 Chapter 10 Annex A.

69. When a contract contains a derivative and the whole contract is not already at fair value, an assessment must be made of whether the embedded derivative is closely related to the host contract. Where it is not, the embedded derivative must be separated from the host contract and accounted for as a standalone derivative, being valued at its fair value.

70. Determining whether an embedded derivative is closely related should be done on a case by case basis. IAS 39 does not define closely related. Part 2 Chapter 10 Annex A lists examples of embedded derivatives that are likely to be closely related to their host contracts.

71. If TLBs consider that they have embedded derivatives but are unsure of the accounting treatment, they should seek advice from FMPA A&TM.

Disclosure

Quantitative Disclosures

72. The following is disclosed for each of the financial assets and financial liabilities categories:

a. the amounts at the beginning of the financial year and as at the reporting period date;

b. all movements in year, e.g. fair value movements, acquisitions, disposals and transfers;

c. the cumulative impairments in value as at the beginning and the end of the financial year on the appropriate basis of amortised cost or fair value, the impairments for the period and adjustments in respect of disposals or for other reasons.

73. Where the investment in a listed financial asset is significant – for example, ownership of 10% or more of the shares, the following are disclosed:

a. the name of the investee;

b. its country of incorporation (or base country);

c. a description and the proportion of investment held;

d. the amount of income (in the SOCNE).

74. For each investment which represents an interest in a subsidiary undertaking, an associate or joint venture which falls outside the boundary or a public body to which PDC has been issued, the Department should disclose its share of any of the following:

a. net assets;

b. turnover;

c. profit or loss.

Special or 'Golden' Shares

75. The following information on special or 'golden' shares should be disclosed:

a. the full name of the body in which the share is held;

b. the nominal value;

c. a brief description of the terms of the shareholding;

d. an indication of where further detailed information can be obtained (i.e. the annual report and accounts).

Qualitative Disclosures

76. The objective of IFRS 7 is to give users of financial statements an enhanced understanding of the significance of financial instruments to an entity's financial position, performance and cash flows.

77. To meet this objective, the qualitative disclosures required by IFRS 7 include:

a. information on the significance of financial instruments for an entity's financial position and performance;

b. information on any exposure to risks arising from financial instruments. This includes certain minimum qualitative disclosures about credit, liquidity and market risks together with descriptions of management's objectives, policies and processes for managing those risks. Quantitative disclosures are also required on the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management.

78. Due to the largely non-trading activities of the Department and the way in which it is financed, it is not exposed to the degree of financial risk commonly faced by business entities. In fact, financial instruments play a much more limited role in creating or changing risk than would be typical of listed companies to which the IFRSs mainly apply. Within the Department, financial assets and liabilities tend to be generated by day-to-day operational activities rather than used as a tool to manage financial risk.

79. As such, disclosures are only necessary where the Department holds financial instruments that are complex or play a significant medium to long term role in its financial risk profile. Where the Department does not face significant medium to long term financial risks, then it is sufficient to make a statement to that effect.

80. The financing of entities covered by the FReM is ultimately tax-based and therefore the Department does not need to follow the IFRS 7 requirement to disclose information on how capital is managed.

Guidance

81. Guidance on accounting for financial instruments is given in Part 2.

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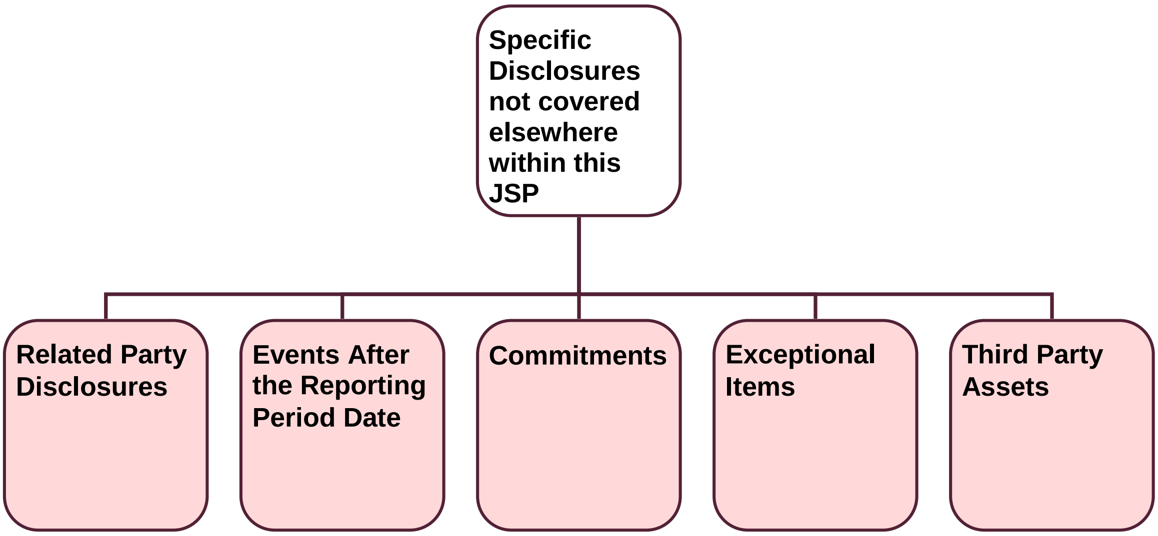
11 Specific Disclosures



Introduction

1. This chapter sets out specific disclosure requirements not covered elsewhere in this JSP.

Specific Responsibilities

2. Specific responsibilities are listed below.

TLBs

3. TLBs are responsible for:

   a. identifying events which occur after the reporting period date that need to be disclosed;

   b. ensuring all their material capital and financial commitments are reported to FMPA CFAT in the format specified in the Annual Accounts Instructions.

Related Party Disclosures

4. The Annual Accounts should disclose any information which is necessary for drawing attention to the possibility that the reported financial position and results may have been affected by the existence of related parties and by internal transactions with them. Refer to Part 2 Chapter 11 paragraph 2 for the definition of a related party.

Disclosure

5. Only material transactions need be considered. Materiality should be judged ‘in the surrounding circumstances’ and thus be judged from the viewpoint of both the entity and the related party. Materiality is defined in Part 1 Chapter 1 paragraphs 16 to 20.

6. To prevent the related parties note becoming unduly long, it has been agreed that central government bodies should provide:

a. the name of the parent department (if any);

b. a note of the main entities within government with which the Department has had dealings. No information about those transactions need be given;

c. details of material transactions between the Department and individuals who are regarded as related parties.

Events After the Reporting Period Date

7. Events after the reporting period date are those which occur between the reporting period date and the date on which the Annual Accounts are approved.

8. The two types are:

a. an adjusting event, for which the Annual Accounts are adjusted;

b. a non-adjusting event that may require disclosure but does not require the Annual Accounts to be adjusted.

9. Examples are given in Part 2 Chapter 11 paragraphs 5 to 8 of adjusting and non-adjusting post reporting period events.

The Dating (Approval) of the Annual Accounts

10. The date (approval) on which the Accounting Officer authorises the financial statements to be issued is normally the same as that of the Certificate and Report of the Comptroller and Auditor General.

11. The date of authorisation for issue must be included in the Annual Accounts but not on the title page. The statement should read, ‘The Accounting Officer authorised these financial statements for issue on [insert date of issue]’.

Commitments

12. Commitments are disclosed as either capital or financial commitments.

Capital Commitments

13. Capital commitments relate to proposed capital expenditure.

14. Details of material capital commitments should be included in the notes to the Annual Accounts if not already included elsewhere.

15. Details are disclosed of the actual or estimated aggregate amount of capital expenditure contracted for, but not accrued or provided for, at the reporting period date.

Financial Commitments

16. Where material to assessing the Department's financial position, details of financial commitments not disclosed elsewhere in the Annual Accounts should be included in the notes to the accounts.

17. For Annual Accounts disclosure purposes, financial commitments do not include outstanding purchase commitments.

18. Financial commitments are likely to be relevant to assessing the Department's financial position when they represent future obligations or unusual risks to the Department, either because of their nature, size or duration.

19. Examples of commitments that need to be disclosed are given in Part 2 Chapter 11 paragraphs 9 to 12.

Exceptional Items

20. Exceptional items are material items which arise from events or transactions that fall within the ordinary activities of the Department but need to be disclosed because of the nature of their size or incidence.

21. Exceptional items are charged or credited to the Statement of Comprehensive Net Expenditure (SOCNE) under the relevant headings. The amount of each item is disclosed separately by way of a note or, if the nature of the item warrants prominence, on the face of the SOCNE.

22. The test should be whether non-disclosure could affect the users' understanding of the relative application of resources to different objectives. Such items may include (but should not be limited to):

a. losses or gains on the disposal of NCAs;

b. major 'insurance' losses where the risk is self insured;

c. costs relating to objectives which are no longer current, such as early departure costs and retrospective awards;

d. other exceptional events.

Third Party Assets

23. Third party assets are assets for which the Department acts as custodian or trustee but in which neither the Department nor the government overall has a direct beneficial interest. Third party assets are not public assets and should not be recorded in the SOFP. Third party monies should not be held in public bank accounts.

24. Third party assets should be reported by way of a note. The note should differentiate between:

a. third party monies and listed securities. The minimum level of numerical disclosure required is a statement of closing balances at the year end. For listed securities, this will be the total market value;

b. third party physical assets and unlisted securities. The disclosure may be by way of narrative note. For physical assets, the note should provide information on the asset categories involved. Such disclosure should be sufficient to give users of the Annual Accounts an understanding of the extent to which third party physical assets and unlisted securities are held by the entity; and

c. in the event that third party monies are found to have been in a public bank account at the end of the reporting year, this should be disclosed in the note on cash at bank and in hand. It should also be disclosed as part of the requirements identified in Part 1 Chapter 11 paragraphs 24a and 34b above.

Guidance

25. Guidance on: the definition of a related party; examples of adjusting and non-adjusting post reporting period events; and financial commitments is given in Part 2.

12 Losses and Special Payments

Introduction

1. This chapter sets out the requirements for identifying, classifying, managing, and reporting losses and special payments. Throughout this chapter 'write off' is used to signify that the case e.g. the loss of equipment, write-down in value, cancelled contract, overpayment etc is no longer being pursued and will be closed. This chapter deals with the requirement (often additional to any accounting action that must be taken) to have the loss approved, including in some cases the requirement to seek PUS's approval or HM Treasury's approval, and, when the case is fully documented, approved and closed, to report the loss to Parliament.

Identifying Losses

2. From time to time it may be necessary to make decisions that lead to transactions outside the usual planned and approved range, eg: write-off of unrecoverable debts or overpayments; recognising losses of inventory, equipment or other assets; recognising the costs of early termination of contracts and projects; extra contractual payments to service providers; fruitless payments e.g. for hotel accommodation or rail tickets or training courses not used or undertaken; extra-statutory payments to claimants; ex gratia payments; special severance payments or gifts of assets. As parliament does not agree or approve advance provision for potential future losses when voting money or passing specific legislation, such transactions when they arise are subject to greater scrutiny and control than other payments.

3. Many of the transactions above require accounting action but, in addition, they will also need to be actioned, in accordance with this chapter, as losses and the appropriate approvals sought and reports made to Parliament.

4. Losses which arise from direct contact with or as a consequence of enemy activity are not reportable to Parliament.

Classifying Losses

5. Losses and special payments must be categorised and reported (quarterly) using the categories set out by HM Treasury and detailed in the tables below. Figures 1 & 2 also include details of the MOD's delegations for each category. Appropriate approvals need to be sought, in accordance with these levels of delegation and further delegations from PUS to TLB Holders, as part of managing the case for the loss or special payment.

Figure 1: Categories and MOD Delegation Limits – Losses

Type	Losses Description	MOD Delegation Up to Limit:
A (i)	**Cash losses** - The physical loss of cash and cash equivalents including bank notes, credit cards, electronic transfers and payable orders.	£100m
A (ii)	**Bookkeeping losses** - A bookkeeping loss occurs when an asset balance or transaction in the accounts is written off because there is no definitive evidence that confirms or denies the existence of the asset or supports the transaction e.g. writing off asset balances which cannot be linked to physical assets, or balances that should have been cleared on project completion.	£100m
A (iii)	**Exchange rate fluctuation** - (excludes movements in the FOREX programme). A loss arises when unused foreign currency is converted to sterling at a different rate to the one at which it was issued	£100m
A (iv)	**Losses of pay, allowances and superannuation benefits** paid to civil servants, members of the armed forces and non-departmental public bodies' employees as follows:	
	Over-payments due to miscalculation, misinterpretation or missing information; such as an error in calculating pension contributions which are then written off. Unauthorised issues e.g. payments that would not be recovered in a court of law.	£100m
	Losses arising from other causes e.g. non-disclosure of full facts by the beneficiary, short of proven fraud.	None
A (v)	**Losses arising from overpayments** of grants, subsidies etc. arising from miscalculation, misinterpretation or missing information.	None
A (vi)	**Losses arising from failure to make adequate charges** including: charges for the use of public property or services, failure to charge non MOD staff using military flights or for services provided by military personnel to non-public organisations.	None
B (i)	**Losses of accountable stores.** Losses that are the result of proven or suspected fraud, theft, arson or sabotage or any other deliberate act, including repairable damage caused maliciously to buildings, stores even where a legal claim is not possible.	£100m
B (ii)	**Losses of accountable stores** not covered by B (i) e.g. spares delivered that later cannot be located or spares that have been destroyed in fires which started accidentally.	£100m
C (i)	**Fruitless payments.** Payments where the Department receives nothing useful in return and: should not have incurred the liability; or could have taken appropriate action to avoid incurring the liability. For example: the cost of repairing incorrectly packed equipment damaged in transit, the cost of rectifying design faults arising from poor specification, failure to cancel travel, accommodation and training bookings in time to obtain a refund.	£100m
C (ii)	**Constructive losses.** These occur when factors affect core programme decisions causing early withdrawal/cancellation of equipment/services e.g. withdrawing equipment from service following a Strategic Defence and Security Review or cancelling a project due to unforeseen technical difficulties.	£100m
D	**Claims waived or abandoned.** The Department decides not to pursue a claim which it is legally entitled to make.	£250k

Figure 2: Categories and MOD Delegations – Special Payments

Type	Special Payments Description	MOD Delegation Up to Limit:
E1	**Extra-contractual payments.** Payments must be supported by prior legal advice and are payments which, though not legally due under contract, appear to place an obligation on MOD which the courts might uphold. Typically these arise from action or inaction in relation to a contract. Payments may be extra-contractual even where there is some doubt about the Department's liability to pay, e.g. where the contract provides for arbitration but a settlement is reached without it. (A payment made as a result of an arbitration award is contractual.)	£1m
	Ex-gratia payments to a contractor. Payments must be supported by prior legal advice. They include the following: Payments to contractors outside a binding contract e.g. on the grounds of hardship. An out of court settlement to prevent a contractor from instigating legal action; where there is no recognition bt the Department of liability.	£250k
E2	**Ex-gratia payments other than to a contractor.** Payments that go beyond administrative rules or where there is no statutory cover or legal liability. For example, Payments made to meet hardship caused by official failure or delay.	£250k
E3	**Compensation payments (excludes the Civil Service Injury Benefit Scheme).** These, payments, to redress personal injury or loss to an individual, can only be made on legal advice. Payments are outside statutory schemes or contracts. Payments for stress, hurt feelings, loss of reputation inconvenience etc are subject to additional controls and should be treated as novel and contentious.	£250k
E4	**Extra-statutory payments and extra-regulatory payments.** These are payments, based on legal advice, are within the broad intention of the statute or regulation but which go beyond a strict interpretation of its terms.	£250k
E5	**Special severance payments.** A payment made to an individual who leaves Departmental employment. The payment must be related to the reason for leaving. It includes out of court settlements where the legal advice is that the Department is likely to lose - for example, a claim raised through the employment tribunal process.	None

6. If a case does not readily fall into a specific category, it should be assigned to the one which it most closely fits.

Management and Control of Losses and Special Payments

7. All losses and special payments must be correctly documented and approved in accordance with the delegations issued. A full audit trail must be maintained (and

provided to auditors if requested). Most losses will be approved within TLB delegations but where these are exceeded:

a. and are within Departmental limits a case for write off should be submitted to PUS, via DG Fin (copy to FMPA CFAT); and

b. where the Department's delegation is exceeded, HOCF FMPA A&TM CFAT2 for Losses and Special Payments, other than Special Severance Payments, for approval by HM Treasury.

c. there is no Departmental authority to approve Special Severance Payments therefore all requests for approval to make a Special Severance Payment should be sent to HOCF-FMPA-Ahd Governance.

8. All losses and special payments are reported, quarterly, in accordance with the annual financial reporting instructions – in most years an AP3 Return will not be required. Where completion of a loss or special payment case exceeding £300,000 is likely to be protracted, a best estimate of the value should be included in the quarterly return as an advance notification.

9. Reporting of Special Severance Payments to the Cabinet Office is undertaken by HOCF-FMPA-Ahd Governance.

10. In writing off a loss or making a special payment a review of the adequacy of related control systems must be undertaken and where any shortcomings are identified, appropriate action must be taken to address them – these actions should be documented.

11. Irrespective of any delegated authority or the value of a loss or special payment, HMT must be consulted (via the points of contact in paragraph 7b) before any write-off action is taken or a special payment made that:

a. involves important questions of principle;

b. raises doubts as to the effectiveness of existing systems;

c. contains lessons which might be of wider interest;

d. is novel or contentious;

e. might create a precedent for other Government Departments in similar circumstances; or

f. is the result of obscure or ambiguous instructions issued by HMT.

12. Should a settlement agreement accompany a special payment then Ministerial approval will be required for the inclusion of any confidentiality clause. See the Defence

Intranet – Personnel/Civilian/Conduct and Behaviour/Concerns and Whistleblowing for further detail.

Reporting Losses and Special Payments

13. Where a single set of circumstances, a defect or an irregularity gives rise to multiple losses, their total value should be exposed by grouping them together and reporting them as a single loss. The individual losses must still be detailed separately in the losses register, regardless of their value and can be approved individually but for reporting quarterly reporting they should be grouped together.

14. Any individual loss or special payment whose value exceeds £300,000 must be identified separately in the quarterly returns; these cases will be separetly reported to Parliament – via the Annual Accounts. Cases below £300,000 are summarised in the Annual Accounts.

15. TLBs are responsible for submitting details of all reportable losses and special payments (including those of sponsored Arm's Length Bodies) in accordance with the requirements of this chapter and the annual financial instructions.

16. For bad debt write-offs, TLBs are responsible for providing the necessary approvals (unless the TLB has provided a financial delegation to DBS) but the DBS Invoice and Revenue (I&R) Team is responsible for reporting the bad debt write-offs, in the quarterly returns, through the Head Office and Corporate Services TLB.

17. If a loss case affects more than one TLB, only one loss case is to be raised and this is completed by the TLB with the greatest involvement. Other TLBs involved in the case are responsible for providing the lead TLB with any costs and details required to support the loss case.

18. Where a Non-Current Asset (NCA) write-off is required for a NCA in use, and the NCA is on the ADMT's Statement of Financial Position (SOFP), the lead operational user (for example, the Front Line Command) is responsible for:

a. raising an advance notification for a reportable NCA loss of £300,000 or above;

b. raising and processing the required papaerwork; and

c. sending an Asset Change Notification (ACN) to the Asset Data Management Team.

19. When an NCA loss is identified during a non-operational period for example, when a major refit and overhaul is undertaken, DE&S is responsible for reporting the loss (including the ACN) and will be the lead TLB.

20. It should be noted that, whilst all NCA and inventory write-offs require an adjustment to the accounts, not all losses are reportable in the ARAc, see JSP472 Part 2 Guidance.

Further Reading

HM Treasury - Managing Public Money

13 Liabilities - HM Treasury and Parliamentary Reporting Requirements

Introduction

1. This chapter explains the nature of liabilities, and the circumstances under which HM Treasury (HMT) approval must be obtained. It also explains the circumstances where, if the liability exceeds £300k, approval to notify Parliament is necessary. The liabilities in question are those which are within the ambit of the vote, but which have not been included in Estimates. The chapter also sets out the reporting process which must be followed.

2. Throughout this chapter, liabilities which require HMT approval and notification to Parliament are referred to as 'reportable liabilities'.

3. To ensure that the differences between Parliamentary reporting requirements set out in HMT Managing Public Money and the financial accounting requirements set out in the Government Financial Reporting Manual are fully understood, it is recommended that this chapter is read in conjunction with Part 1 Chapter 8.

Definitions

4. Liabilities may be actual or contingent:

   a. actual - an obligation to pay another party an amount in the future – e.g. an accrual, a provision or a contractual commitment to make payments in future years under long term contracts, such as the procurement of major equipment;

   b. contingent - a financial obligation to pay another party in the future if certain circumstances materialise – e.g. where the Department issues an indemnity, guarantee, letter of acceptance or comfort.

Key Points

5. Actual liabilities are reportable if they are novel or contentious or involve significant costs downstream - e.g. nuclear decommissioning costs.

6. Contingent liabilities are reportable unless the Department can demonstrate that the contingent liability will be incurred in the context of a specific range of circumstances described below:

   a. within the Limiting a Contractor's Liability & Indemnities Commercial Policy Statement (CPS) indemnity chapter (paragraphs 56-91) of the Commercial Toolkit;

   b. by statute; or

   c. by standard commercial leasing arrangements; or

d. by one of the redundancy indemnities contained in HMT PFI Standardisation of Contracts; or

e. by the Government's standard indemnity to Board members (which also includes civil servants involved in legal proceedings).

7. Any actual or contingent liabilities associated with proposals to accept charitable funding are reportable.

8. Contingent liabilities for £300k and below can be approved by the Director of Resources (DRes), however, if the liability is related to operations or considered to be novel and/or contentious, HMT approval must be sought.

9. For reportable liabilities that exceed £300k, HMT approval must be sought to incur the liability and to notify Parliament, before a contract is signed. Allow at least ten working days for HMT approval for contingent liabilities.

10. Parliament is notified by laying a Departmental Minute (DM). However, if the liability is considered to be sensitive, a DM should not be laid, so approval must instead be sought from HMT to send a letter 'in confidence' to the Chair of the Public Accounts Committee (PAC). Refer to Figure 1 for the full distribution list.

11. The required format and content of the DM are shown in Figure 2. For the letter to the Chair of the PAC, the wording in the opening and closing paragraphs of Figure 2 should be customised and information requirements a. to e. met. The letter should also explain why it is necessary to report the liability 'in confidence'.

12. The DM must justify why the Department is entering into a reportable liability. Note that even the strongest value for money argument does not negate the requirement to seek HMT approval and to notify Parliament before entering into any commitment. The Department will usually be expected to meet the cost of the liability (if it comes to fruition) from within existing budgetary provision.

Policy Detail

13. Policy detail is set out under the following headings: specific responsibilities; identifying a reportable liability; approval and Parliamentary reporting process; reporting liabilities outside Parliamentary sessions; Annual Accounts disclosures; and Supply Estimates.

Specific Responsibilities

14. Specific responsibilities are listed below.

Commercial Officers' Responsibilities

15. It is the responsibility of all officers responsible for acquisition to ensure that additional risk is not transferred to the Department, unless there is a justifiable reason for accepting financial liability, for example if it demonstrates value for money. Commercial officers should ensure they follow the process set out in the Limiting a Contractor's Liability & Indemnities (CPS):

a. **Actual liabilities**. The commercial officer must inform the finance officer if the contract terms involve significant costs downstream - e.g. nuclear decommissioning costs as these are classified as actual reportable liabilities. The commercial officer must also inform the finance officer if any actual liabilities appear to be novel and/or contentious which could give rise to a contingent liability.

b. **Reportable contingent liabilities**. If a contractor is attempting to transfer risk or financial liability to the Department through either seeking an indemnity (excluding Part 1 Chapter 13 paragraph 30 a-g), or to limit their liability the commercial officer must involve their finance officer. They must follow the 'How to Review a Limitation of Contractor's Liability' process in the Limiting a Contractor's Liability & Indemnities (CPS) (paragraphs 43-47).

c. **Non-reportable contingent liabilities**. If a commercial officer intends to use any of the pre-approved indemnities at Part 1 Chapter 13 paragraph 30 a-g they must notify the finance officer. These contingent liabilities must still be notified to HMT in accordance with the appropriate accounting treatment (see Part 1 Chapter 8 – liabilities). If using the Generic and Special Risk indemnities, the acquisition team must understand the obligations to which they commit the Department (see Limiting a Contractor's Liability & Indemnities (CPS) paragraphs 58-59).

Project Officers' Responsibilities

16. As a risk assessment is always performed to understand the level of financial risk that a contractor may seek to transfer to the Department, project officers are key to identifying potential contingent liabilities. See Commercial Risk Overview for information resources for conducting risk assessments.

Finance Officers' Responsibilities

17. The final decision on whether a contingent liability is reportable is the responsibility of the finance officer. However, inputs from both commercial and project staff are required to assess if there is a value for money case in the contractor's submission to limit their liability.

a. Early Notification of the Team Leader (TL). This early notification is critical if the acquisition team is considering including an indemnity, a limitation of contractor liability, a guarantee or letter of acceptance or comfort in the terms of a contract.

b. Making the decision on a reportable/non-reportable actual or contingent liability. State whether the liability is covered by indemnity or statute as listed in paragraph 30 a-g. If it is a reportable actual/contingent liability ensure that the TL is content to proceed on the basis that the liability is reportable and must therefore be approved by HMT before any commitment is made.

c. Informing the Director of Resources (DRes) in accordance with TLB internal processes. Seeking assurance from the DRes that if the liability came to fruition, the funding would be manageable from within Estimates.

d. Write a value for money case. This must explain the benefits to the Department of limiting the contractor's liability, and why it is considered better value for MOD to hold the financial liability for a contractor's risk despite the Department having no control over it.

18. Even if a liability is not reportable, the finance officer must still seek the necessary TLB financial approval to incur the liability in accordance with internal TLB instructions. However, as HMT requires visibility of all new liabilities, including those that do not require Parliamentary reporting, any new details will taken from the AP 9 and 12 submissions to CFAT which incorporate all liabilities, with the returns used to meet Parliamentary reporting requirements.

Director of Resources' Responsibilities

19. DRes have a delegation to incur contingent liabilities up to and including those for £300k, unless they are novel and/or contentious. However, DRes must ensure that they seek approval from HMT, through HOCF FMPA-A&TM-CFAT1, to incur liabilities above £300k and to report them to Parliament by the laying of a Departmental Minute. This gives visibility to all Members should they wish to raise an objection. An overview of the approvals and Parliamentary reporting process is set out at Figure 1.

20. However, a Departmental Minute cannot be used if the liability is considered to be sensitive and not for release to the public. Instead, HMT approval must be sought to report to the Chair of the PAC by letter 'in-confidence', copy to House of Commons Defence Committee (HCDC).

21. As well as preparing the draft Departmental Minute or letter to the Chair of the PAC, Directors of Resources are responsible for:

a. preparing the associated Ministerial advice;

b. answering any Parliamentary objections;

c. informing HMT of any objections and their outcome.

22. When preparing the draft Departmental Minute/letter to the Chair of the PAC, as appropriate, DRes must provide a robust justification for the proposal to incur the liability. In addition, information must be provided on its scope, value and duration; confirmation must be given that funds will be managed from within Estimates; and also that the liability will be noted in the Accounts.

23. DRes must scrutinise all proposed international agreements for the possibility of a reportable liability. Should a liability be identified, DRes should ensure that the Parliamentary reporting process is correctly followed, even if the agreement is covered by legislation, noting also that 21 Parliamentary sitting days are required for approval. All financial responsibilities of the signatories are usually set out in a Memorandum of Understanding.

24. As government departments cannot indemnify each other, DRes should jointly agree which department will bear any financial consequences.

25. DRes must ensure that the Department does not assume any liabilities through the non-public activities of its staff, for example fund-raising for charities. Individuals involved in non-public activities should seek an indemnity for any personal liability from the non-public organisation.

26. If there is any doubt as to whether or not HMT approval is required, DRes should always seek advice from HOCF FMPA-A&TM-CFAT1. **Note that even the strongest value**

for money argument does not negate the need to seek HMT approval and to notify Parliament before entering into any commitment.

Identifying a Reportable Liability

Actual Liabilities - Reportable to HMT

27. Actual liabilities that are reportable are those that:

a. are considered to be novel or contentious;

b. involve significant costs downstream - e.g. nuclear decommissioning costs.

Actual Liabilities - Not Reportable to HMT

28. The following liabilities are not reportable:

a. liabilities arising in the course of the purchase or supply of goods and services in delivering Departmental outputs – for example, short term accruals and invoices;

b. contractual commitments to make payments in future years arising under long-term contracts – for example, the procurement of major equipment;

c. commitments to pay grants in future years under a statutory grant scheme.

Contingent Liabilities - Reportable to HMT

29. Contingent liabilities are reportable unless the Department can demonstrate that they have been incurred under the circumstances approved by HMT (see Part 1 Chapter 13 paragraph 30 a-g). Other situations giving rise to contingent liabilities are found under paragraph 33-39. However contingent liabilities must be reported regardless of other factors where a material change in value or a significant increase in risk has occurred. There are other situations where a contractor may seek to limit their liability, which could create a reportable contingent liability (see Limiting a Contractor's Liability & Indemnities (CPS) paragraphs 12-17 and 21-41).

Contingent Liabilities - Not Reportable to HMT

30. HMT has agreed that the following contingent liabilities do not need their specific, prior approval. However, all contingent liabilities must be identified and the appropriate accounting treatment applied (see Part 1 Chapter 8 – Liabilities).

a. **'Generic' Indemnity**. The Department offers industry an indemnity in some standard DEFCONs, where MOD accepts the financial liability for certain risks that would usually sit with a contractor (for example DEFCON 91 - Intellectual Property Rights in Software). This indemnity is not reportable to HMT but the potential cost implications of this liability must be understood, and any local level notifications followed. See Limiting a Contractor's Liability & Indemnities (CPS) paragraphs 58-68 for details of generic indemnities.

b. **'Special Risk' Indemnity**. HMT have agreed that for some specialised high risk MOD business, contractors may be relieved of their liability. A 'special risk' indemnity can be provided where no commercial insurance exists to cover the financial liability associated with the related risks. These risks are so extreme that it is neither practical, nor would offer value for money, for industry to hold the financial liability. These indemnities are not reportable to HMT but due to the catastrophic nature of the risk and potential cost implications they must be notified to the appropriate Director of Resources in accordance with your TLB's finance process. See Limiting a Contractor's Liability & Indemnities (CPS) paragraphs 69-92 for details of the following nine 'Special Risk' indemnities, which have been pre-approved by HMT:

i. Aviation Products;

ii. Aircraft Flight and Taxiing Trials;

iii. Refit and Repair of Naval Vessels;

iv. Shipbuilding Contracts;

v. Nuclear Submarine Builders;

vi. Nuclear Risks;

vii. Research and Development Contracts – Guided Weapons;

viii. War Risks;

ix. Diversion of Orders to the Department from Other Customers;

x. Salvage and Towing.

c. Indemnities covered by statute do not need HMT approval, but they should be reported to Parliament in line with any statutory requirements. Indemnities covered by statute (both UK and international) include the following:

i. the Nuclear Installations Act;

ii. the Merchant Shipping Act;

iii. the Anti Deficiency Act (US statute which is relevant in the context of Foreign Military Sales);

iv. the Ordnance Factories and Military Services Act 1984.

d. Leasing contracts which contain standard commercial leasing conditions. For example:

i. BARECON 2001 for shipping charters;

e. The indemnities contained in the Report by the Review Board for Government Contracts;

f. Redundancy indemnities contained in HMT PFI Standardisation of Contracts and incorporated into the TUPE guidance provided in the Commercial Policy Statement within the Commercial Toolkit. HMT has agreed that these indemnities can also be applied to other types of PPP contracts such as outsourcing;

g. The standard indemnity provided by the Government to Board members of central government departments and NDPBs and also to civil servants involved in legal proceedings or formal enquiries arising as a consequence of their employment.

31. Note that if any of the terms of the above pre-approved classes of indemnities are changed in such a way that alters their intent, the resultant liability will be reportable to HMT.

32. Any other indemnity request not included in Part 1 Chapter 13 paragraph 30 a–g above must be treated as a reportable contingent liability.

Other Situations Involving Contractor's Liability

33. As detailed in the Commercial Toolkit in the Limiting a Contractor's Liability & Indemnities CPS, the Department does not provide contractors with a limitation on their liabilities under contract or general law, without good Defence or value for money reasons for doing so.

34. Contractors may often attempt to limit their liability against certain risks as it is a simple risk transfer mechanism. This transfers the financial liability to the Department should the risk occur and protects the contractor, reducing the contractor's risk. The contractor can seek to limit their liability for certain risks (e.g. damage to MOD buildings or poor performance). A detailed list of risks can be found at Limiting a Contractor's Liability & Indemnities (CPS) (paragraphs 23-42).

DEFCON 76 (Contractor's Personnel at Government Establishments)

35. The list of contractor obligations set out in DEFCON 76 is a common example of limitations of their liability. Under the terms of DEFCON 76, the value of the contractor's liability for loss or damage is undetermined. As highlighted in Limiting a Contractor's Liability & Indemnities the onus is on the contractor to seek a limit of liability under DEFCON 76 and it must not be agreed unless it meets the criteria set out in the Commercial Toolkit.

36. If the Department agrees to a limit on a contractor's liability because there are good Defence or value for money reasons for doing so, it will result in a reportable contingent liability unless the following circumstances are met:

a. the clause uses the standard DEFCON wording and commercial staff follow the process laid down in the Commercial Toolkit; and

b. a full and robust risk assessment has been undertaken to identify risks and mitigating action. Project teams will need to defend this risk assessment if necessary. TLBs should satisfy themselves that the risk assessment is robust; and

c. the level of limit of liability is per incident; and

d. the level of rectification costs is below the level of the limit of liability.

37. If any of the above conditions are not met, the subsequent liability is reportable. See Part 1 Chapter 13 paragraph 29.

Acceptance of Charitable Donations

38. All proposals to accept charitable donations by the Department are deemed novel and contentious and HMT approval must be sought. Actual or contingent liabilities that arise from HMT approved charitable funding are within the scope of the novel and contentious category and are reportable.

39. Part 1 Chapter 13 paragraph 30 a-g may not be exhaustive. If any others sources come to light they must be brought to the attention of HOCF FMPA-A&TM-CFAT1 who will review the evidence.

Approval and Parliamentary Reporting Process

40. As explained in Part 1 Chapter 13 paragraphs 19 to 26 under Director of Resources' Responsibilities, reportable liabilities of £300k and below, unless relating to operations or are novel and/or contentious, do not require HMT approval. However, unless novel and/or contentious, all those above £300k require both HMT approval and Parliamentary reporting.

41. An overview of the approvals and Parliamentary reporting process is set out in Figure 1.

This publication has been archived on 13 September 2016.
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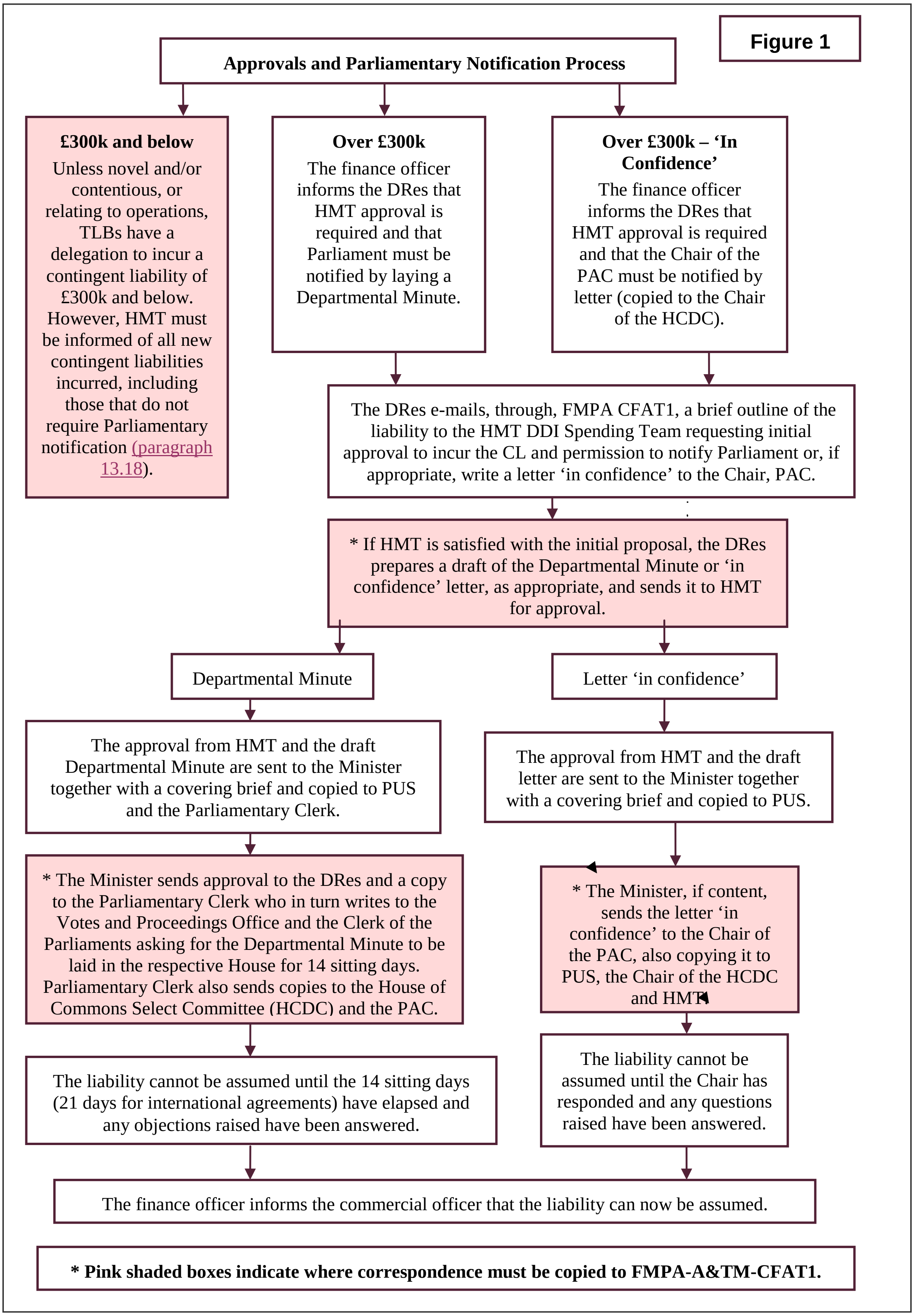

42. The process for laying a Departmental Minute is:

a. the finance officer sends a brief outline of the liability, through HOCF FMPA-A&TM-CFAT1, to HMT seeking authority to incur it. HMT does not wish to see the draft Departmental Minute at this stage;

b. on approval, the finance officer sends a draft Departmental Minute to the DRes, incorporating the standard wording, shown at Figure 2 and sends it to HOCF FMPA-A&TM-CFAT1 for review;

c. HOCF FMPA-A&TM-CFAT1 advises the DRes of any necessary changes to meet HMT requirements;

d. the DRes incorporates any necessary changes and sends the draft Departmental Minute to HMT, copy to HOCF FMPA-A&TM-CFAT1;

e. when the Departmental Minute has been approved by HMT, the DRes forwards the Ministerial Submission together with a covering brief to the Minister, copying them to PUS, HOCF FMPA-A&TM-CFAT1 and the Parliamentary Clerk;

f. the Minister's Office keeps the Parliamentary Clerk informed of progress. Once the Departmental Minute has been approved by the Minister, the Parliamentary Clerk sends it to the Votes and Proceedings Office (House of Commons) and to the Clerk of the Parliaments, Printed Paper Offices (House of Lords) to request that it be laid before the respective House. A copy is also sent to the Chair of the PAC and the HCDC;

g. Parliament must be given 14 sitting days notice in order for Members to raise any objections, although for international defence collaborative agreements 21 sitting days are required;

h. if a Member of Parliament raises an objection by letter to the Minister, a Parliamentary Question or by otherwise raising the matter in Parliament during the normal 14 sitting days notice period, the liability should not be assumed until the objection raised has been answered.. In some cases, the advice to the Minister might be that the objection is sufficient for the liability to be delayed or indeed withdrawn pending further consideration by the Government.

43. The reporting process for a letter "in confidence" to the Chair of the PAC is:

a. the DRes sends a brief outline of the liability, through HOCF FMPA-A&TM-CFAT1, to HMT explaining the nature of the liability and the reason for it to be treated as 'in confidence', seeking authority to accept it and permission to write a letter to the Chair of the PAC 'in confidence'. HMT does not wish to see the draft letter at this stage;

b. on approval, the DRes drafts a letter, which incorporates a suitable adaptation of the framework shown in Figure 2 including all the essential elements listed in a. to e., forwarding it to HOCF FMPA-A&TM-CFAT1 for review;

c. the DRes incorporates any necessary changes and submits the draft letter (copied to PUS) for the relevant Minister's approval;

d. The Minister, when content, sends the letter to the Chair of the PAC and copies it to PUS, the Chair of the HCDC, HMT and HOCF FMPA-A&TM-CFAT1. The liability cannot be assumed until the Chair has responded and any questions raised have been answered.

44. The National Audit Office (NAO) will be informed by HOCF-FMPA-DHd-A&TM of a reportable 'sensitive' liability as the NAO will wish to investigate the background before providing advice to the Chair of the PAC.

45. Any changes to existing liabilities should be reported in the same format as they were originally reported to Parliament. However, any liability, originally reported by letter, but no longer considered to be sensitive, should be reported using a Departmental Minute instead.

46. In emergency situations, consideration may be given to a reduction in the number of days notice to Parliament. The reasons for the emergency must be included in the Departmental Minute. However Parliament, and in particular the PAC, will take a dim view of liabilities reported under emergency conditions if this was due to poor planning and preparation.

Framework for a Departmental Minute/Letter 'In Confidence' to the Chair of the PAC

The opening paragraph should say:

It is normal practice, when a government Department proposes to undertake an actual or contingent liability of £300,000 and above for which there is no specific statutory authority, for the department concerned to present to Parliament a Minute/ to the Chair of the PAC a letter, giving particulars of the liability created and explaining the circumstances; and to refrain from incurring the liability until fourteen parliamentary sitting days after the issue of the Minute/letter, except in cases of special urgency.*

The body of Minute/letter should:

a. set out the reasons for issuing an indemnity that will incur a reportable liability;
b. describe the scope, value and duration of the liability; for a contingent liability, also comment on the likelihood of the liability being called and include an estimate of the maximum exposure;
c. explain which bodies are expected to benefit and why
d ensure that if the liability is called, provision for any payment will be managed through the Estimates procedure;
e. confirm that the Department will be noting the liability in its Accounts.

The letter to the Chair of the PAC must explain why the liability needs to be reported in confidence.

The Minute/letter should have the following closing paragraph:

The Treasury has approved the proposal in principle. If during the period of fourteen parliamentary sitting days beginning on the date on which this Minute was laid before Parliament, a Member signifies an objection by giving notice of a Parliamentary Question or by otherwise raising the matter in Parliament, final approval to proceed with incurring the liability will be withheld pending an examination of the objection

**actual or contingent as appropriate*.

Reporting Liabilities Outside Parliamentary Sessions

47. The Department should avoid reporting a liability to Parliament during a Parliamentary recess. In cases of special urgency it can, with HMT consent, notify the Chair of the PAC (also copying the letter to the Chair of the HCDC). This is done by attaching a covering letter to the draft Departmental Minute which would have been tabled had Parliament been sitting.

48. If the required 14 days' notice cannot be given for reasons of particular urgency, this should be explained in the letter.

49. As soon as the House of Commons re-assembles, the Department should lay the Departmental Minute, having updated it to show the current status of the liability and whether or not it has now been incurred.

Disclosures in the Annual Accounts

50. Although IAS 37 (see Part 1 Chapter 8) states that contingent liabilities are only disclosed in the accounts if they are remote, Parliamentary reporting requires that all actual and contingent liabilities are to be disclosed, regardless of the likelihood of them coming to fruition.

51. However, when disclosing liabilities which are intended to be or have been reported in confidence, care must be taken with the description to ensure that the sensitive aspects of the liability have not been compromised.

52. The indemnities provided in Part 1 Chapter 13 paragraph 30 a-g, also known as schemes, have given rise to contingent liabilities, and will continue to do so. Although each scheme might have incurred several contingent liabilities, HMT is content that only the name of each scheme needs to be disclosed and this will be undertaken by CFAT.

Supply Estimates

53. The Estimate includes details of all contingent liabilities in force which, if they came to fruition, would by exception, involve the voting of additional expenditure though the Estimate. However, this does not replace the requirement to obtain HMT and Parliamentary approval before incurring a reportable liability above £300k.