# Capital Accounting Policy

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## Contents



**This policy applies to the NHS Staffordshire & Stoke-on-Trent Integrated Care Board.**

**Where the term Officers are used this includes Non-executive Directors, Clinicians and contractors working on behalf of the ICB**

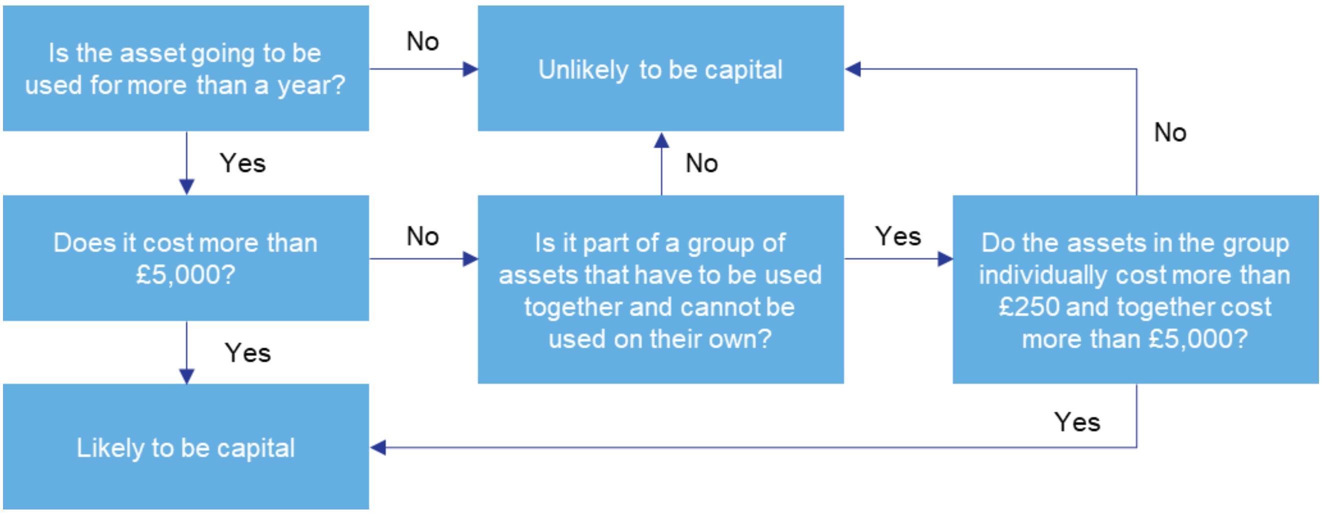
## 1.0 Purpose of the Policy

This policy is aiming to support NHS Staffordshire and Stoke-on-Trent ICB nominated officers to discharge their duties in respect of Capital Investments within the prescribed accounting standards and statutory requirements of the Health and Social Care Act 2022.

## 2.0 Introduction to Capital

In the NHS, expenditure is classified as either revenue (spending on day-to-day operations) or capital (spending on assets that will be used for more than a year). Capital spending is incurred when an asset intended for use on a long-term basis is acquired – this is also described as capital investment.

The Flow Chart below details the questions to be considered to support whether expenditure should be classified as capital. There is a de-minimis level of £5,000 for single items of expenditure below which it would be classified as revenue not capital. Where there are multiple linked assets then the grouped assets concept ensures that it is the overall value of an asset that is recognised, rather than treating dependent component parts as separate items.




### 2.1 Definition of a capital asset

The assets are referred to as non-current assets or property, plant and equipment and intangible assets. They are defined as:

- being held for delivering services or for administrative purposes
- having a useful life greater than one year
- having a cost that can be measured reliably
- generating future economic benefits or service potential for the organisation

### 2.2 Types of asset

| Tangible assets | Intangible assets |
|---|---|
| Land | Software licenses |
| Buildings | Development costs for software and systems |
| Dwellings | Licenses and trademarks |
| Assets in the course of construction | Patents |
| Plant and machinery | |
| Transport equipment | |
| Information technology equipment | |
| Fixtures and fittings | |

## 3.0 The capital regime – allocations and limits

The amount that can be spent on capital across the Department of Health and Social Care (DHSC) group is set by the government. The amount that can be spent in any one year is called the capital departmental expenditure limit (CDEL)

Overall responsibility for ensuring that the allocation is not overspent rests with the DHSC. The limit is set for each year and any unspent allocation is lost at the end of the year. It is therefore important that the limit is reached but not overspent.

### 3.1 System capital allocations

Allocations at a system level, and the needs for a revised capital allocation process, were described in the health infrastructure plan (HIP). The HIP can be located via this link **Health Infrastructure Plan (publishing.service.gov.uk)**

The HIP identified three key requirements to make NHS infrastructure fit for the future:

- a new five-year rolling programme of investment in NHS infrastructure that takes a strategic approach to improving hospitals, primary and community care estates, and health infrastructure
- a reformed system underpinning capital to ensure it reaches the frontline when and where it is needed
- backing the wider health and care sectors with funding to strengthen health infrastructure in related sectors that support the NHS.

### 3.2 Capital resource limit

System allocations are provided to integrated care boards (ICBs), with each organisation receiving a capital resource limit (CRL) for the financial year.

Integrated care systems (ICSs) determine which capital projects at which NHS bodies get priority. This will be managed through the Staffordshire System Capital Group, and each

ICB and its partners trusts are subject to a capital resource limit (CRL) on their combined capital resource.

Each ICB and its partner trusts are required to agree an annual system capital plan, in advance of the start of the financial year.

**For ICBs, remaining within this limit is a statutory duty, they should not exceed it and it is monitored throughout the year.**

Performance against the CRL must be reported in the ICB annual report and accounts. The ICB should not spend more than the CRL after adjusting for asset disposals. Underspends against the CRL cannot be carried forward to the following financial year unless they are agreed in advance and built into submitted plans.

For an ICB, its own CRL represents the amount of financing given to it for capital expenditure by NHS England.

## 4.0 Sources of capital

If the ICB does enter a capital programme, the only sources of funding available to it are internally generated funds, leases or a capital allocation provided by NHS England

### 4.1 Internally generated resources

The main source of capital funding is from internally generated resources – the cash balances built up through retained surpluses, depreciation, and proceeds from the sale of non-current assets.

The ICB makes a charge to expenditure to reflect the cost of using an asset over its useful life, and this is known as depreciation (or amortisation for intangible assets). This charge does not involve actual cash being paid out (it is ‘non-cash’) and so if the ICB broke even or achieved a surplus on its revenue account it would generate a cash surplus equivalent to the value of the depreciation charge (all other things being equal).

That cash balance and/ or any surplus is available to invest in capital projects, such as replacing equipment, enhancing existing assets or building new ones, subject to the organisation meeting the capital controls set out. It can also be used for revenue purposes.

### 4.2 Leases

A lease is often considered a suitable alternative to the outright purchase of a non-current asset.

A lease is defined as a ‘contract, or part of a contract, which conveys the right to use an asset for a period of time in exchange for consideration’.

From 1 April 2022, the accounting treatment for leases changed. The change has an impact on what is charged against CDEL as well as the profile of revenue expenditure over the life of the lease.

Under IFRS 16, lessees will account for all leases as a right-of-use asset, and with a liability to pay for that right. At the commencement of a lease, the lessee’s initial measurement of the right-of-use asset is at cost, which in general, will be the same as the initial measurement of the discounted lease liability. This will ensure that the accounts will include the assets being used by an organisation to provide services, together with the associated liabilities, and the impacts on cashflows.

**All new leases, as well as some changes to lease terms, will count as a capital investment and will impact on CDEL.**

Lessors will continue to distinguish between operating and finance leases. This means that where two NHS bodies enter into a lease arrangement, they might both reflect the asset in their accounts. The lessee as a right to use the asset and the lessor as the owner of that asset.

## 5.0 The cost of capital

In terms of the cost of capital, there are two key elements to consider – Public Dividend Capital (PDC) and depreciation.

### 5.1 PDC dividend

The PDC dividend is derived by applying a percentage rate of return to an ICB’s average relevant net assets, calculated as follows:

The percentage used is currently 3.5%; the dividend is payable to the DHSC in two instalments during the year.

### 5.2 Depreciation and amortisation

Depreciation is calculated annually to reflect the cost of ‘using up’ the asset during its useful life – several assumptions are used:

- land is considered to have an infinite life and is not depreciated
- buildings, installations and fittings are depreciated over their assessed useful lives, with both the value and life expectancy determined periodically by a qualified valuer
- assets in the course of construction are not depreciated until they are brought into use
- equipment is depreciated over its useful economic life
- leased assets are depreciated over the shorter of the lease term remaining or the asset’s remaining economic life.

NHS Staffordshire and Stoke-on-Trent ICB calculates depreciation on a ‘straight line basis’ which means it is assumed that the asset will be used up evenly over its life. As depreciation is calculated on asset values that are subject to revaluation, the depreciation charge and total value of the assets held will vary each year.

Amortisation is the equivalent for intangible assets and NHS Staffordshire and Stoke-on-Trent ICB again calculates this on a straight-line basis.

## 6.0 Accounting Treatment

Accounting for capital can be complicated and is often an area of the accounts subject to additional audit scrutiny. This is because, by its very nature, the amounts involved are usually material but also because there can be a significant level of judgement and estimation in the valuation of the assets.

### 6.1 Accounting standards

HM Treasury have developed a *Financial reporting manual* that sets out how accounting standards should be implemented in the public sector. The DHSC's *Group accounting manual* also includes guidance on accounting for non-current assets. The following accounting standards are of particular relevance when accounting for capital:

- IAS 16 Property, plant and equipment
- IAS 20 Accounting for government grants and disclosure of government assistance
- IAS 36 Impairment of assets
- IAS 38 Intangible assets
- IAS 40 Investment property
- IFRS 5 Non-current assets held for sale and discontinued operation
- IFRIC 12 Service concession arrangements
- IFRS 16 Leases.

### 6.2 Valuation

In the ICB, non-current assets are not recorded in the accounts at the amount that they cost to buy. Instead, they are held at 'fair value'. Fair value is essentially the amount that the asset could be bought for on the open market.

On acquisition, non-current assets are recorded at their cost, and for equipment assets, this will, by its nature, be a reasonable estimate of their initial fair value. Equipment is usually valued at depreciated historic cost where they have short useful economic lives or low value.

Property assets will require annual review to ensure the valuation included is a reasonable estimate of fair value. The nature and timing of a revaluation is dependent on several factors which are discussed below.

For the ICB (as other NHS organisations), Specialised property for which a market value cannot be determined easily, are valued at the cost of replacing it with an equivalent, modern one (known as the 'modern equivalent asset basis').

Assets that are not specialised, such as offices and some clinics, are valued based on what they could be sold for.

Under IAS 16, the ICB must consider whether the recorded value of their assets continues to reflect fair value taking into account market volatility - for example, if the local property market is particularly volatile or the organisation embarks upon a significant capital expenditure project, annual revaluations may be needed to keep the recorded value up to date.

Each year, an assessment must be made of whether the valuations are materially correct or not. This will involve consideration of the volatility of the property market and usually requires discussion with a professional valuer. In years where a professional valuation has not been undertaken, the value given to land and buildings will need to be reviewed and any changes appropriately evidenced to support the preparation of the accounts. Valuation may also be required when:

- there is a major change in use
- an asset formerly under construction is brought into use.

Most intangible assets (i.e., assets that have a financial value even though they are not visible) are recorded at cost less 'amortisation' as a proxy for fair value. However, where a market value is readily available then this should be used.

### 6.3 Gains

Gains (or increases) in asset value may occur following a revaluation by an external reviewer or, for equipment assets, by a review undertaken by the finance and/or estates departments to provide a new fair value.

The gain is not treated in the same way as revenue or income. Instead, it is taken to a specific revaluation reserve held within the financing section of the organisation's statement of financial position.

### 6.4 Impairments

Impairments occur where there is a loss (or reduction) in the value of a non-current asset compared to its recorded value. This can be due to:

- a loss of economic benefit to an asset itself - for example, it is physically damaged
- a change in the asset or its environment that has permanently reduced its capacity to provide services.

IAS 36 is the most relevant accounting standard, however, HM Treasury guidance diverges from IAS 36 and requires organisations to identify the cause of impairment as the result of either:

- the consumption of economic benefits or service potential or
- a loss following revaluation.

In the first scenario, the resulting loss is charged to operating expenses in the year that the impairment occurs.

However, where there has been a previous upward revaluation for the asset and a revaluation reserve balance exists, a transfer is made from the revaluation reserve to the general fund/ retained earnings.

In the second scenario, a revaluation loss, the reduction should initially be charged to the revaluation reserve to the extent that a balance exists for the asset. Any remaining amount is charged to operating expenses.

If impaired assets then have an upward valuation, the charge made to expenditure can be reversed to the extent that the upward revaluation reverses the original impairment. It is therefore important to record all impairment charges by individual asset to enable entries to be reversed if needed.

### 6.5 Asset sale or disposal

When assets are sold or scrapped, the difference between the value at which they are held, and the amount of income received is the profit or loss on disposal. In the case of assets that are scrapped the income will be nil so there is likely to be a loss on disposal.

The ICB will reflect profits on sale in other operating income. Losses are to be treated as an operating expense in the year of disposal.

### 6.6 Leases

When a lease is entered into, the right of use asset is recorded in the asset register with a corresponding matching lease liability. The asset is treated as if it had been bought outright as soon as it becomes operational. It forms part of average relevant net assets for PDC dividend calculations, is subject to depreciation and is revalued in the same way as any owned asset. The lease liability is written down as the capital element is repaid. The interest payments on the lease are treated as an expense each year.

The profile of the expenditure on leases that would have been operating leases under the old accounting arrangements has changed. Under the old arrangements, operating lease rentals were charged to revenue as they were incurred, usually on a straight-line basis. Now, interest payments are higher at the start of the lease and lower at the end whereas depreciation charges are on a straight line over the length of the lease.

## 7.0 Fixed Asset register

The ICB maintains a register of its non-current assets (tangible and intangible) so that they can be managed effectively and to demonstrate accountability. The register used is the national Financial Management Information Systems (FMIS) which is mandatory for all ICBs. The register records a range of information about each asset and is used to help in the preparation of the ICB’s financial accounts and helps enable replacement programmes.

### 7.1 Asset registers – what they record for each asset

- identification, description and location of the asset – assets are tagged with a unique identifier
- date, method of acquisition and initial capital outlay
- how the asset has been financed - for example, is it owned, leased, donated or covered by a PFI agreement.
- opening value on the 1 April of each financial year
- any additions to the asset and the year that they were made
- the value if reclassified for sale
- gains from revaluation (so that there is a clear link to the revaluation reserve)
- impairments (i.e., a loss in value) including any reversals
- cumulative depreciation charges and estimated life
- closing value on 31 March of each financial year

## 8.0 Review

This policy will be reviewed every two years from the point of implementation.

NHS
Staffordshire and
Stoke-on-Trent
Integrated Care Board